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UNITED STATES OF AMERICA

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COMMODITY FUTURES TRADING COMMISSION

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PUBLIC MEETING OF ADVISORY COMMITTEE

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Washington, D.C.

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Wednesday, October 26, 2010

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1 PARTICIPANTS:

2 Commission Members:

3 GARY GENSLER, Chairman

4 BART CHILTON, Commissioner

5 MICHAEL V. DUNN, Commissioner

6 SCOTT D. O'MALIA, Commissioner

7 JILL E. SOMMERS, Commissioner

8 Staff:

9 ADRIANNE JOVES

10 General Counsel

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12 BELLA ROZENBERG

13 Division of Market Oversight

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15 JON DEBORD

16 Division of Clearing and Intermediary Oversight

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18 EILEEN DONOVAN

19 Division of Clearing and Intermediary Oversight

20

21 ROBERT PEASE

22 Division of Enforcement

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1 P R O C E E D I N G S

2 (9:30 a.m.)

3 CHAIRMAN GENSLER: Good morning. This
4 meeting will come to order. This is a public meeting
5 the Commodity Futures Trading Commission to consider
6 issuance of a number of proposed rules to further the
7 Commissions' actions on the Dodd-Frank Reform and
8 Consumer Product Act.

9 Today we will be considering -- it's six,
but

10 let me list them. It's six rules, I think:
11 Certification and Approval of Rules, and New Products
for
12 Designated Contract Markets, Derivative Clearing
13 Organizations, Swap Execution Facilities, and Swap Data
14 Repositories. These are rules that would have on how
15 they move forward on their rules.

16 Secondly, removing, as the Dodd-Frank Act
17 asked us to do, any reliance on credit ratings in
various
18 Commission regulations.

19 Thirdly, amending various regulations we have
20 to provide greater protections for customer funds held
by
21 futures, commission, merchants, and derivative, and
22 clearing organizations.

4

1 Fourthly, I processed a review in the
2 designation of swaps for mandatory clearing.

3 Fifthly, enhancing the Commission's ability
4 to protect against manipulation.

5 And then sixth, an advanced notice of
6 proposed rulemakings. This is not actually a proposed
7 rule, but it's to ask the public -- I think it's 18
8 questions -- advanced notice and proposed rulemaking on
9 disruptive trading practices.

10 Before we hear from the staff, once again I'd
11 like to thank my fellow Commissioners for all of their
12 hard work on the Dodd-Frank Act and all of our existing
13 authorities.

14 I believe that Commissioner Dunn, I just want
15 to make sure, is tied in somehow through modern
16 technology. Commissioner Dunn, are you with us?

17 COMMISSIONER DUNN: I am here.

18 CHAIRMAN GENSLER: Terrific.

19 COMMISSIONER SOMMERS: He's on the video.

20 CHAIRMAN GENSLER: He's on the video there

in

21 our Chicago office, if I understand it right. I would
22 also like to welcome members of the public market

5

meeting, 1 participates and members of the media to today's
2 as well as welcome those listening and watching by
3 webcast.

consider 4 This is our third public meeting to
5 Dodd-Frank rulemaking. And included in today's
actions, 6 I anticipate that we will have published two final
rules; 7 one of them called an "interim final rule." I think
that 8 we would have proposed 11 rules, if the rule count is
9 correct, and published three advanced notices of
proposed 10 rulemakings.

11 And while a great deal of effort is going
12 into this, this is still likely to be about a quarter
of 13 the work that we have. And that's only a quarter in
the 14 first phase called proposals; because, of course,
really 15 the very importance of finalizing these rules next
spring 16 will be before us.

17 We currently plan to have at least three
18 public meetings in November and two public meetings in
19 December. The dates and topics will be published, of

20 course, in the Federal Register. And we're looking to
21 our next meeting on the Dodd-Frank Act rulemaking on
22 November 10.

6

1 The arithmetic of course will show that
2 this will be a very busy next seven weeks. And no
doubt
3 as we're human, some of these rules may slip.
4 And there will be new stories, I guess,
on
5 whatever that may be. But our goal is really to
complete
6 the proposal stage by mid December. And as you will
see
7 even on this disruptive trade practices, we'll probably
8 have that proposal after mid December because we
thought
9 it was appropriate to go out to the public to get more
10 information.

11 I want to thank the staff for all of the
12 work that they've put in drafting the rulemakings and
13 consideration today. I thank them for their thoughtful
14 recommendations how the Commission shall go forward.

And
15 we look forward to receiving the public comment which
is
16 really just enormously critical for us.

17 These, again, are just proposals that we're
18 considering. So each of these rules will have a
serious
19 of questions in them and seek public comment.

20 We're also putting fact sheets and Q&As on

21 our website, which I hope will help the public
understand
22 what we're doing.

7

1 Before we turn to the staff, I would like
to 2 turn my fellow Commissioners for opening statements. I
3 think Commissioner Dunn, if we can do this through the
4 video conference.

5 COMMISSIONER DUNN: Thank you Mr. Chairman.
6 Is this working?

7 CHAIRMAN GENSLER: Yes.

8 COMMISSIONER DUNN: Can you hear me?

9 CHAIRMAN GENSLER: We can hear you very
well.

10 COMMISSIONER DUNN: Fine. Today we will
before 11 consider the next set of proposed rules that come
12 the Commission pursuant to the Dodd-Frank Act. As with
13 other proposed rules, today's set of rules offer a
14 glimpse into the resource-intensive reengineering the
CFTC 15 will be doing throughout to provide regulatory
framework 16 to prevent many new -- to implement many new
17 responsibilities under the Dodd-Frank.

18 As I have previously stated, I am very
19 concerned about the CFTC budget situation and possible
20 attempts to thwart implementation of the Dodd-Frank by
21 cutting off funding for this agency. There was just a

22 piece in Reuters this morning indicating that that
might

8

I 1 be a strategy. Without the requisite level of funding,
2 see possibilities of several unfortunate outcomes as a
3 result of that. Let me enumerate these.

capital 4 First, without the necessary human
5 to review new SEFs, DCMs and DCOs applications, I can
6 envision a long waiting periods for potential
registrants 7 before their applications are approved to conduct
8 business in the markets we regulate.

9 This inability to quickly and efficiently
would 10 process applications, through no fault of the SEF,
11 undoubtedly prevent the immediate creation of a
12 competitive market environment, at least in the OTC
portions 13 space. And may lead to greater systemic risk as
14 become concentrated in the small group of SEFs, DCMs,
and 15 DCOs that are not versed to navigate the registration
16 process.

17 Similarly, the lack of adequate resources
may 18 undoubtedly affect the agency's ability to approve new
19 products for trading. If the CFTC does not have the
20 people to review new product applications to ensure
they

21 are not violative of the Act and are not readily

22 susceptible to manipulation, the new products cannot be

9

1 listed for trading.

the

2 Again, I fear that a long queue will
3 develop for new products waiting approval. And that
4 inability to get new products approved will prevent
5 innovation and competition in our markets.

need

6 Without adequate funding, the CFTC may
7 to delegate a substantial portion of its duties under
8 Dodd-Frank to the industry established as SROs.

will

9 If we cannot be the frontline regulator, it
10 is incumbent upon the Commission to find someone who
11 be. Delegation of this oversight duties to the
12 SROs will obviously be very costly to them, but
13 necessary.

existing

14 And lastly, a principle-based regulatory
15 regime only works if the regulator has the staff
16 necessary to ensure that its regulatees are adhering to
17 the principle. Without sufficient staff to conduct
18 proper oversight, the CFTC may need to write a more
19 prescriptive set of rules and rely more heavily on
20 burdensome reporting requirements. Again, this
21 undoubtedly will be very costly to the industry and
22 market users.

10

necessary 1 It is my hope the CFTC receive the
2 funding and allow us to continue to provide the quality
3 oversight it's always provided. This oversight to
4 following a principles-based approach in my opinion
5 fosters an environment of compliance, competition, and
6 innovation.

want 7 Mr. Chairman, I want to thank you and I
8 to thank the staff for again hosting these series of
9 meetings. I think this has been one of the most open
10 processes that any regulators has ever had asked. And
I 11 appreciate all of the hard work that has gone into it.
12 Thank you.

13 CHAIRMAN GENSLER: Thank you, Commissioner
14 Dunn for your remarks. Commissioner Sommers?

15 COMMISSIONER SOMMERS: Thank you, Mr.
16 Chairman. I want to say that I first agree with many
of 17 the comments made by Commissioner Dunn this morning
18 regarding our resource restraints. And I hope that
that 19 gets worked out as Congress returns.

20 I want to say thank you to the rulemaking
21 teams for all of their hard work that have been put
into

22 these proposals that are before us today.

11

our
a
1 And I guess I thought that with proposing
2 11 rule today out of 30 rulemaking teams, that we were

3 third finished, not a quarter finished.

4 CHAIRMAN GENSLER: Commissioner Sommers, my
5 math is not very good.

6 COMMISSIONER SOMMERS: Okay. Good. I was
7 thinking there's something I don't know about this.

8 CHAIRMAN GENSLER: Well, I do have to admit
9 that Sarah has broken her business conduct into
numerous
10 rules.

11 COMMISSIONER SOMMERS: Right. There's more
12 than we even know. Anyway, thank you very much. I
look
13 forward to discussing the important rules before us
this
14 morning.

15 CHAIRMAN GENSLER: Thank you, Commissioner
16 Sommers. Commissioner Chilton?

17 COMMISSIONER CHILTON: Thanks, Mr.
Chairman.

18 I agree with the fiscal concerns that were raised by
19 Commissioner Dunn and Commissioner Sommers and
constantly
20 by our Chairman and by our appropriations staff, too.

21 This is important because we're dealing

22 with anti-disruptive practices and with manipulation.

12

1 The law has been really weak in these regards over the
2 years, which is why many of us fought to get it
changed.

3 And this rule, the proposal will help promulgate these
4 things. And we will be better to enforce the rules to
5 make more efficient, effective markets in the future

6 I did want to take a moment to comment on
7 precious metals, in particular silver. We've been
having
8 an investigation that's been going on 25 months now.

And
9 I've been urging -- not that there's any individual
that
10 has not agreed, but I've been urging that we say
11 something publically at some point.

12 I think that the public has been for two
13 years asking about whether or not there's wide-spread
14 manipulation in the markets. And it just seems to me
15 that after a couple of years we should say something.

We
16 can say yes. We can say no. But it's time to say
17 something.

18 The legal definition, as I said, of
19 manipulation is really hard to prove. It's a high bar.
20 It's a much test. It's a much different test than what
21 the average person if we walked out on the street might
22 think of as manipulation; because you not only need to

13

1 have a specific intent, but you also need to prove as a
2 result of that intent and the market control that the
3 adaptively caused an artificial price. And causing an
4 artificial price is something that can be debated by an
5 economist, so it's a really high bar. But what we're
6 doing today will help in that regard.

7 Attempted manipulation is a little easier
to
8 prove than manipulation. It requires the intent to
9 manipulate and some overt act in furtherance of that
10 intent.

11 And then there are lesser violations,
there's
12 are several of them. And after we do disruptive
trading
13 practices, there will be even more. So we will be
adding
14 additional tools to sort of our tool box of things that
15 can help in these markets.

16 I do believe that there have been repeated
17 attempts to influence price in the silver markets.
There
18 has been fraudulent efforts to persuade what I consider
19 deviously control that price. And this is based upon
20 what I have been told by members of the public and
21 reviewed in publically, available documents.

22
Commodities

I believe there are violations to

14

markets. 1 Exchange Act that have taken place in the silver

2 And that any such violation should be enforced by
3 prosecuted by the government.

4 Now, in saying this, I'm prohibited from
5 divulging anything about your investigation, about
getting

6 individual trader names, or about positions, and I'm
7 specifically not doing. And I can't pre-judge anything
8 that my colleagues and I may or may not do on this or
any
9 other matter.

10 So I appreciate that we're going forward on
11 this. I believe that disruptive trading and the
12 anti-manipulation rule along with position limits will
13 help not only the precious metal markets and fully
14 implemented, but help all markets to make them more
15 efficient and effective and avoid fraud, abuse, and
16 manipulation. Thank you.

17 CHAIRMAN GENSLE: Thank you, Commissioner
18 Chilton. Commissioner O'Malia?

19 COMMISSIONER O'MALIA: Thank you, Mr.
20 Chairman. I would like to thank the teams for their
many
21 long hours developing these rules that we will consider
22 here today. The staff has actively sought input from
the

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1 Commissioners and worked cooperatively to approve each
2 these rulemakings.

3 I'd like to thank Bella Rozenburg and her
4 team, Adrienne Joves, and Eileen O'Donovan and their
5 respective teams. I would also like to thank Phyllis
6 Dietz and John DeBord for their efforts.

7 However, I'm quite concerned about the
8 proposed rule with the investment customer funds. I
9 think they're overly prescriptive, especially given
that
10 the Commission released an advanced notice of public
11 ruling on this very issue in May of 2009.

12 My main concern with this proposal is that
13 the Commission is proposing to significantly revise the
14 scope and f character of permitted investments of
15 customer funds in the face of numerous public comments
to
16 the contrary.

17 In fact, the concentration limits in
today's
18 proposed rule seem to suggest that the 2000 plus pages
of
19 the Dodd-Frank Act have done nothing to improve the
20 safety and the liquidity of the money market funds.

21 I strongly urge the public to comment on
the

limits, 22 reasonableness of the asset-backed concentration

16

1 especially the 10 percent limitation on money-market
2 funds. I also question whether it is wise to allow 50
3 percent of the allocation to be invested in one
4 government-sponsored enterprise.

5 I intend to oppose the rulemaking, as it
6 fails to consider the public comments and fails to
7 provide sufficient justification for the proposed
8 allocations.

9 Moving to the Anti-Manipulation. I'd like
to
10 thank Bob Pease and Mark Higgins for their efforts to
11 present us with rules regarding an incredible
12 controversial area of our law.

13 In the vernacular of the futures
industries,
14 there is one term that stands out above all others.
15 Manipulation. "M" is the Scarlet Letter of the futures
16 market.

17 When the Enforcement Division, traders, and
18 the defense bar speaking of the big "M" they are
thinking
19 of a very specific kind of conduct. The intentional
20 creation of an artificial price, as Commissioner
Chilton
21 pointed it out.

22 It requires having the specific intent to

17

1 affect prices in a manner that is not legitimately
2 brought about by the forces of supply and demand.

3 To fully comprehend the scope of this
4 rulemaking and the advanced notice of proposed
5 on disruptive trading practices, one must understand
6 the range of prohibited misconduct under the CEA.

7 To do this, it helps to think of the
8 possible violations of the CEA on a continuum ranging
9 from the trade price violations such as wash sales to
10 full manipulation.

11 New sections provided by the Dodd-Frank Act
12 and provide additional points on the continuum in the
13 form of disruptive trading practices and fraud-based
14 manipulative schemes. The placement of these points on
15 the continuum will be determined by these rulemakings.

16 The foundation of the Commission's
17 rulemaking authority is preserved on one end of the continuum to
18 the new section 6(c)(3). These rulemakings mirror the
19 statutory prohibition to clarify the Commission's
20 interpretation of price manipulation is an intentional
21 interference with the legitimate forces of supply and
22 demand.

18

change
9(a)(2).
section

1 It is important to know this will not
2 the Commission's enforcement under the existing
3 Fraud-based manipulative schemes described in new
4 6(c)(1) differs from big "M" manipulation in that the
5 prohibited conduct may be intentional or reckless. And
6 that there is no requirement for such conduct to result
7 in artificial price.

8 Taking one step back along the continuum,
9 disruptive trading practices are also defined in some
10 instances as reckless conduct.

executed
trading,

11 Accordingly, trade strategy that is
12 under unpredictable, atypical market conditions could
13 misfire and fall under the enumerated disruptive
14 practices.

15 If the Commission determines that the
16 strategy was engaged in recklessly, it could find that
17 the strategy was manipulative even if the trader had no
18 intent to impact market prices or disrupt the market
19 itself. This would be an aggressive outcome, but it is
20 entirely possible under this continuum.

21 It is therefore incumbent upon this
22 Commission to be clear about which type of activity is

19

authorities. 1 prohibited and how we intend to use our new

2 Last week NFL Commissioner Roger Goodell
3 notified players that striking an opponent in the head
4 and neck will result far more significant discipline
5 including suspension.

6 When I read this, I realized that
7 Commissioner Goodell's job is very similar to that of
the
8 Commission. He places a high priority on protecting
the
9 players from needless injury.

10 The CFTC also places an equal value on
11 protecting markets participants from manipulation,
market
12 disruptions, fraudulent behavior, and other abuse
13 practices. The new statutory provisions charge us with
14 defining controls to ensure that the trading is neither
15 disruptive nor manipulative.

16 These provisions also impose high penalties
17 for conduct which may only be reckless. A rather low
18 standard under the law to ensure that market
participates

19 are incentives to follow the rules. To the NFL's
credit,

20 it has been very specific about what it will and will
not

21 tolerate.

20

market 1 will not provide, our rulemaking will not provide
2 participants with the same comfort or sufficient
3 direction. This is especially true with regard to
4 disruptive trade practices.

5 One would think after requesting this
provide 6 language in the legislation, the Commission could
7 some more details as to how it will interpret the
8 language on spoofing or trading in the close.

9 As a result, it is appropriate for the
10 Commission to receive more feedback from the public to
11 better refine these definitions and understand how they
12 might, in fact, impact markets or the players affected.
13 And I appreciate, Mr. Chairman, you going with advanced
14 notice of proposed rulemakings to further flush these
15 out.

16 We must not lose sight of the technology
to 17 investments such rulemakings might require. In order
18 effectively oversee trading schemes and practices, the
19 Commission will need to reconstruct the order book and
to 20 understand how various bidding strategies have impacted
21 market practices. Regardless if we apply intent of a
22 reckless standard, all cases must be supported by the

21

1 facts and empirical data.

2 As we work through the particular
3 rulemakings, it is critical to remember that our
4 responsibility is broader than simply responding to the
5 last crisis. Going forward, prevention and deterrence
6 must be the twin goals that are furthered by
7 anti-manipulation and disruptive trading rules.

8 Stating upfront that the Commission may
9 always go back to the instant replay to review the call
10 does not provide market participants with a fair notice
11 as to when their strategies will run afoul of the
rules.

12 It is my sincere request that the public
13 provide input on the complicated rulemakings to ensure
14 that everyone is in agreement of the boundaries and
fair
15 play. Thank you.

16 CHAIRMAN GENSLE: Thank you, Commissioner
17 O'Malia. I want to thank all of my Commissioners,
fellow
18 Commissioners for their comments. And I find my
19 associating with each of you in a different way. So I
20 hope it's a third, by the way.

21 I definitely associate with Commissioner
Dunn

22 on the need for resources. I'm going to continue to be

22

1 sort of a happy advocate for resources. And I truly do
2 hope that when Congress comes back from the election,
3 that we get the necessary resources to move forward.

4 I do believe even our estimate of 400 new
5 staff to incorporate Dodd-Frank may well end up being a
6 low estimate given the markets that we're to oversee.

We

7 probably will have 300 to 400 new registrants. And the
8 markets are presently seven to nine times the size of
9 markets that we currently oversee.

the

10 And I find myself associating with
11 Commissioners O' Malia and Chilton, though maybe a
12 bit different perspectives, on the need to have clearer
13 rules of the road when handling manipulation and
14 disruptive trading practices. I do think that we need
15 enhance our authorities in that regard, and Dodd-Frank
16 gave us that.

little

to

17 Let me turn over to the staff
presentations.

18 The first set of proposed rules that we are considering
19 relate to something in our Commission which we call
20 40." Part 40 is just part of our rules. And these are
21 about how we as the Commission approve or consider the

"Part

22 various rules and new products of registrants, that's

23

1 what Part 40 is.

Shilts

2 Bella Rozenburg with the Division of Market

3 Oversight, I guess with support from her boss Rick

4 at times is going to discuss these proposals.

5 With that I think I might -- I think I'm

6 supposed to go through and introduce everybody. So I

7 will introduce everybody.

today

8 The second set of proposals considered

9 will address the removal of the reliance on credit

10 ratings and proposals, alternatives to this alliance

11 reliance. So Adrienne Joves from our Division of the

12 Office of General Counsel is going to prevent that.

13 The third set the proposed rulings being

14 considered relate to the investment of customer funds

of

15 under regulations 1.25 and 30.7. And also in that set

16 rules we'll regard the use of credit rating agencies as

there.

17 well. And I believe that -- I see Phyllis sitting

18 Are you going to present that?

19 MS. DIETZ: Jon DeBord.

20 CHAIRMAN GENSLE: So Jon DeBord from out

21 Division of Clearing an Intermediary Oversight will

22 assist Phyllis and present that.

24

1 The fourth set of proposal describe the
2 process for reviewing swaps for mandatory clearing
Eileen 3 Donovan -- where is Eileen -- there on the second row
4 will be doing that from the Division of Clearing and
5 Intermediary Oversight.

6 The fifth set will be addressing the
7 discussion about the manipulation standards where I
think 8 Mark Higgins and Bob Pease will be coming to table from
9 the Division of Enforcement.

10 And then finally, there will be the
proposals 11 regarding disruptive practices, and Bob Pease will be
12 doing that.

13 In terms of the staff will present the
14 proposal in each case. And in each these the floor
will 15 be open for questions and we will take a vote.

16 So number one, Bella. I think then if you
17 want to give a presentation and then we will do a
motion. 18 MS. ROZENBURG: Good morning, Mr. Chairman,

19 Commissioners. Today's staff is recommending that the
20 Commission approve a number of proposed rulemaking to
21 implement new rules certification procedures for
existing

22 registered entities such as designated contract market

25

1 and derivatives clearing organizations, and for new
2 registered candidates such as Swap Execution Facilities
3 and Swap Data Repositories.

4 The proposed regulation also prohibits
event

5 contracts based on certain excluded commodities special
6 procedures for certain rule changes proposed by
7 systemically important derivatives clearing
organizations

8 or safe codes. And provide for the following of review
9 periods for certain novel derivative products pending
the

10 resolution of jurisdictional determination. I will
11 address major changes for Part 40.

12 With respect to rule certification
13 procedures, under the proposed rules, the Commission
will

14 have 10 business days to review certification or will
15 amend them.

16 If within 10 business days the Commission
17 determines that the submission involves a novel or
18 complex issue or is submitted with an inadequate
19 explanation or is potentially inconstant with the Act,
20 then the certification will be stayed for an additional
21 90 days.

22 The rule amendment will be certified upon

26

1 expiration of the 90-day review period unless the
2 Commission objects to the certification.

3 Under the proposed rule, if the Commission
4 stays the review for an additional 90 days, then the
5 Commission will provide a 30-day public comment period.
6 The Commission will provide notice of the comment by
7 posting the notice and their submission on the
8 Commission's website.

9 With respect to certification procedures
10 for submission of rules by the SIDCO, the proposed
11 regulations will require SIDCO to provide the
Commission
12 with a 60-day advanced notice of any proposed change to
13 its rules or procedures that could materially affect
the
14 nature or level of risk presented by the SIDCO.

15 Under the proposed rules, changes that
16 could materially affect the nature or level of risk are
17 those that there's reasonable possibility that the
18 changes could substantially affect the performance of
the
19 essential inquiry and settlement function or the
overall
20 nature or level of risk presented by the SIDCO.

21 Such changes could include changes that
22 materially affect financial resources, participates and

27

1 product eligibility, risk managements, default
2 procedures, system safeguards, and governance.

3 The proposed regulation would allow SIDCO
4 to implement the proposed rule change if the review
5 period lapses without Commission action.

6 The proposed rule would allow the
7 Commission during the 60-day review period to extend
the
8 review period for an additional 60 days if the proposed
9 change raises novel or complex issues.

10 With respect to event contracts, the
proposed
11 rule prohibits the listing, trading, or clearing of
12 products that are based on certain excluded commodities
13 and that involve, terrorism, assignation, war, gaming,
or
14 an activity that is unlawful under any State or Federal
15 Law. These prohibited activities are specifically
16 enumerated in the statute.

17 In addition, the proposed rule provided
in
18 the product involved activity similar to that activity
19 prohibited by the statute. And if the Commission
20 determines such product to be contrary to the public
21 interest, then the product will be prohibited in the
22 future rulemaking.

28

the
request
completion

1 If during the review of a new contract,
2 Commission determines that such product may involve any
3 of the prohibited activities, the Commission will
4 that the registered entity suspended the listing or
5 trading of the product and will conduct a 90-day review
6 to determine whether the product violates the
7 prohibitions on certain event contracts. Upon
8 of this review, the Commissioner will issue a
9 determination order.

10 Finally, under the proposed rules, if the
11 registered entity submits a product that may have
12 elements of both a security and a derivative, the
13 Commission or the SEC may request a jurisdictional
14 determination from the other agency.

the

15 If a jurisdictional determination is
16 requested, the Commission will toll the applicable
17 product certification or approval review period until
18 issuance of a final determination order.

additional
product

19 If the Commission or the SEC seeks
20 review of the jurisdictional determination, then the
21 charge order as well as the review period for the

22 will be stayed until the United States Court of Appeals

29

upon

1 for the District of Columbia circuit issues a final
2 determination. This review period will resume only

3 a finding that the Commission has jurisdiction over the
4 submission.

5 That concludes my remarks. I will be happy
6 to take any questions.

7 CHAIRMAN GENSLER: Thank you, Bella. The
8 Chair will now entertain a motion to accept the staff
9 recommendation and issue the proposed rules regarding
10 Part 40.

11 COMMISSIONER O'MALIA: So moved.

12 COMMISSIONER SOMMERS: Second.

13 CHAIRMAN GENSLER: With the motion made and
14 seconded, I would like to open the floor to my fellow
15 Commissioners to ask any questions.

16 I just have one, Bella. If you can help to
17 clarify for the public. In terms of these rules as I
18 under them, we have a different approach for rule
review

19 and product review. The presumption -- is that correct
20 that product reviews would only happen in a small set
of
21 circumstances, but rule reviews might happen more
often?

22 MS. ROZENBURG: That is correct. We have

30

1 different procedures for product approval and product
2 certification versus rule approval and rule
3 certification. Product certification procedures and
4 products approve procedures remain largely the same.

5 With respect to the rule approval
procedures,
6 would have this new requirement and applies to rule
7 amendments, as well. We have this new requirement of
10 and 90 days.
8

9 I just want to be clear that when the
10 registered entity submits a contract that changes the
11 terms and conditions of a contract, it is considered to
12 be a rule amendment. And therefore, it has to follow
the
13 new rule amendment certification procedures for 10 and
90 days.
14

15 CHAIRMAN GENSLER: I see. But the goal of
16 Congress was to give these clearing house rules and
maybe
17 the designated market rules. We have 10 days. Most
18 rules probably within the 10 days would not be novel or
19 complex and they would go into being.

20 MS. ROZENBURG: That is correct.

21 CHAIRMAN GENSLER: And if staff then says
no

22 there is something novel, complex, or is systemically

31

1 important clearing house, if it might be a different
2 term, material, then we have further review in that
3 period 90 extra days to review it?

4 MS. ROZENBURG: That's right.

5 CHAIRMAN GENSLER: Thank you.

6 MR. SHILTS: And with the opportunity for
7 public comment during that 90 days.

8 CHAIRMAN GENSLER: Right. That's a good
9 point. So if we put it out for the 90 days and we seek
10 public comment by putting it right up on our website
11 getting public comment?

12 MS. ROZENBERG: That is correct. If we're
13 going to stay, if the Commission is going to stay the
14 review period for 90 days, then the Commission will
15 publish a notice on the website along with this
16 Commission. That will be available.

17 CHAIRMAN GENSLER: Again, the presumption
18 the end of the 90 days is that the rule would go into
19 effect unless the Commission determines by majority
20 and so forth that it not go into effect?

at

rule

21 MS. ROZENBERG: That is correct.

22 CHAIRMAN GENSLER: I didn't have anything

32

1 further. Commissioner Dunn?

Chairman.

2 COMMISSIONER DUNN: Thank you, Mr.

3 Bella, could you describe for me the difference in the
4 procedures that we are currently operating versus the
5 these proposed procedures on the timeline implementing
a new product.
6

as

7 MS. ROZENBURG: On the products or rule
8 amendments or new rules? For products the procedure,

9 I said, remain the same. When a registered entity
10 submits a new product for certification, this product
11 will be certified within one business day.

for

12 If a registered entity submits a product
13 approval, they follow the standard procedures that are
14 currently Part 40. The product will be approved within
15 45 days or maybe expanded in the rules novel for
complex issues.
16

complex

17 With respect to rule certification
18 procedures, this process is different from what we have
19 currently in Part 40. Right now under current
20 regulation, when the registered entity submits a rule
21 amendment or new rule by certification, this rule will
go

go

22 into effect within one business day. One business day

33

1 after it submits the submission to us, provided
2 submission to the Commission. This will change. Now
the
3 Commission will have 10 business days to review
4 submission before it goes into effect.

5 As I mentioned, many submission probably
will
6 go will -- become effective within 10 business days.

7 However, is if the submission have one of those novel
or

8 complex issues, then the Commission may stay the review
9 for an additional 90 days and the Commission will
provide

10 a notice of comment and post the notice on the
Commission
11 website.

12 COMMISSIONER DUNN: As I understand on that
13 procedure, we're going from immediate the next day to
as

14 long as 160 days. Is that --

15 BELLA ROZENBERG: I'm sorry, would you
repeat
16 your question?

17 COMMISSIONER DUNN: For a rule then instead
18 of being certified and going into effect the next day,
it
19 will be at least 150 days or up to?

20 BELLA ROZENBERG: No. The rule will go
into

21 effect once the registered entity submits -- once the
22 Commission receiving a certification, then the
Commission

34

1 will have 10 business days to review the submission.

know,

2 If the Commission determines that, you

any

3 it's just this regular submission. It didn't involve

4 novel or complex issue and it's complete, then the rule

5 will go into effect upon expiration of 10 business days

6 review period.

the

7 However, within 10 business days Commission

8 determines that there is a novel or complex issue or

9 submission is incomplete, then it will inform the

10 registered entity that it will stay the review for an

11 additional 90 days.

if

12 And after that expiration of the 90 days,

13 the Commission didn't act on it or didn't inform the

14 registered entity, the rule will go into effect unless

15 the Commission notifies otherwise.

think

16 CHAIRMAN GENSLER: Commissioner Dunn, I

be

17 what you're asking what the total review period would

18 for a submission that raises novel issues. It would be

19 the 10 business days plus the 90 days. So around 105

20 days or something like that, if that's what you're

21 asking?

22

COMMISSIONER DUNN: Then how is that

35

1 different from current process?

amendments

2 MS. ROZENBERG: Currently, rule

business

3 and rule certifications are effective within one

4 day. So there is 10 and 90 days.

5 COMMISSIONER DUNN: Thank you.

Commissioner

6 CHAIRMAN GENSLER: Thank you,

7 Dunn. Commissioner Sommers?

8 COMMISSIONER SOMMERS: Thank you, Mr.

of

9 Chairman. My questions are with regard to the review

would

10 event contract. If I understand correctly the process

11 for self-certification of the event contracts they

12 follow the same procedures. That if you self-certify,

as

13 they can go into effect the next business day as long

14 everything is in order.

15 And my question is: What kind of review do

16 we contemplate under 40.11 that would allow us the time

17 to review an event contract within one business day?

in

18 MS. ROZENBERG: Well, currently, under the

19 Dodd-Frank Act there are certain contracts, event

20 contracts that are explicitly prohibited that will be

21 Part 40. If a registered entity submits an even

22 contract, and its opinion does not involve one of those

36

1 prohibited activities, it will file a regular
2 certification. It will the follow product
certification
3 procedures under 40.2.

4 So during that staff conduct review of
5 certifications or they become in effect within one
6 business day, so during that review, the Commission
staff
7 determines that one of those contracts may involve one
of
8 prohibited activities, the Commission, the staff will
9 request that the registered entity will suspend the
10 trading of this contract and will conduct a 90-day
review
11 as required by Dodd-Frank Act.

12 So within 90 days if the Commission
13 determines that this contract involves the similar to
one
14 of the prohibited activities and is contrary to public
15 policy, then the Commission will issue determination,
and
16 it will issue a rule prohibiting this type of a
contract.

17 So basically for now the procedure is going
18 to be if the registered entity thinks that its contract
19 does not involve one of the prohibited activities, that
20 will fall under 40 the regular certification procedure.
21 And it's the staff's responsibility to look for this

prohibited 22 contract and, you know, to see if, they may be

37

1 understand 40.12.

2 MR. SHILTS: Yes. There's no specific
3 statutory stay or whatever for these types of
contracts.

4 So presumably, we get them in.

5 For those that are enumerated are pretty
6 clear as to what they mean. So it's mostly the staff
7 have to look at them and say this is potentially
similar

8 to one of these. It raises questions. We immediately
9 get back to the Exchange. And mostly likely they
10 wouldn't list it until this determination is made with
11 the 10-to-90-day provision for rule certification
during

12 the specific statutory provision for that. So it's
13 something we have to work with the Exchange.

14 But typically, if the Exchange has a
15 contract that they think is questionable, as we've seen
16 in the past, they usually talk to us in advance. And
17 we'll have some notice about that.

18 COMMISSIONER SOMMERS: And I assumed that.
19 But I guess I just had some concerns about whether we
20 were comfortable with that one day review.

21 MS. ROZENBERG: Dodd-Frank didn't give us
the
22 authority to play any sort of stay on the review.

38

1 COMMISSIONER SOMMERS: Okay. Thank you.

2 CHAIRMAN GENSLER: And just for the public,
3 these enumerated items are terrorism, war, gaming --

4 MS. ROZENBERG: Assassination.

5 CHAIRMAN GENSLER: -- assassination.

6 MS. ROZENBURG: Any contract that my
violate

7 any State or Federal law. It's pretty clear.

8 CHAIRMAN GENSLER: Hopefully, terrorism,
9 assassination, these things are pretty clear, but there
10 may have been some ambiguity at the time. Anything,
11 Commissioner O'Malia?

12 COMMISSIONER O'MALIA: So I'm clear, if the
13 movie guys came in under this language and were not
14 previously banned, we will have to certify them in one
15 day?

16 MS. ROZENBERG: Well, the contract will
17 go into effect, but certifying doesn't mean approval.
18 The Commission can come back anytime and ask them if we
19 determined that one of the activities is involved in
20 prohibited activity, we can request now under the new
21 authority, we can request the registry and stop trade
22 will conduct review.

39

under 1 In my opinion, that will become -- fall
2 the issue of whether this event contract is gaming or
3 not. But it's clearly not assignation or war that will
4 be the most controversial issue to define what gaming
is. 5

6 MR. SHILTS: Typically, as with those, the
7 Exchanges don't certify them and list them immediately.
8 They wouldn't want the legal uncertainty of not knowing
9 what the Commission is going to do.

could 9 So even though I guess conceivably that
10 happen, our experience is that if they think there's
any 11 sort of a question, they walk talk to the staff and the
12 Commission as to what they think, with respect to these
13 new rules, whether they think they might violate, the
14 Commission my have some concerns for them.

15 COMMISSIONER O'MALIA: So your
recommendation 16 to the events contracts entity people might be
proposing 17 event contracts and then expect a 90-day review?

18 MR. SHILTS: If it relates to some of those
19 and anything that's listed in that list. It wouldn't
be 20 something else like a cropped deal or something or
21 whatever.

and 22

CHAIRMAN GENSLER: Rick, I understand --

40

1 I think it's a very good question. I understand that
2 today, prior to Dodd-Frank, if one of the designated
3 contracts markets of the Chicago Mercantile * Exchange
4 had decided to do a movie future, they could self-
certify
5 it in one day.

6 But, you know, it was just because of the
7 unique circumstance where somebody is coming in for a
8 both, they were both setting up a new exchange and
doing
9 a new product. Is that right?

10 MS. ROZENBERG: That's right.

11 CHAIRMAN GENSLER: As they say, timing is
12 everything. But now those are banned. Any other
13 questions? There's a motion on the floor and seconded.
14 So I would like to just, if there are no further
15 questions, thank the staff and for their presentation.

16 And I will say I do support this rule. I
17 will have my little statement published in the Federal
18 Register, but I do support the rule. I think it does
19 give market participants clarity on how we will do
this.

20 The Dodd-Frank Bill set up the 10 and 90
21 day procedure and it systematically imported contract
22 clearing organization 60 and 60. But I think the rule
is

41

participants 1 an excellently drafted trying to give market

2 the clear procedures to do that. But I didn't know if
3 anybody else wanted to say anything.

the 4 COMMISSIONER CHILTON: I'd like to thank

5 staff for doing a great job on this. We appreciate it.

6 CHAIRMAN GENSLER: So if there are no other
7 views, all those in favor say "Aye"?

8 (Chorus of ayes.)

9 CHAIRMAN GENSLER: Any opposed? The ayes
10 having it, we'll send it long to the Federal Register.
11 With that, I think we might have swap out of some folks
12 here. Adrienne Joves I think will present with the
13 General Counsel's office with regard to credit rating
14 agency.

can't 15 As I understand the Dodd--Frank Act, I

stop 16 remember. It must have been Title 9 said we have to

to 17 relying on that in any of our rules. Being the first

18 review to see where we relied, Adrienne will tell us
19 probably the seven places we do that.

Deputy 20 And Adrienne Joves is assisted by our

21 General Counsel. And his entire staff have been

22 tirelessly working on all of the rules because he heads

42

1 up the regulatory piece from the General Counsel's
2 office. Adrienne?

3 MS. JOVES: Thank you, Chairman Gensler.
4 Before I provide a brief summary on our proposal and
5 credit rating, I don't want to recognize and thank our
6 other team members. Jon DeBord, who will shortly give
7 you another proposal and another rulemaking, for all of
8 the efforts he attributed to on a proposal that we will
9 be discussing on credit rating.

10 I also wanted to briefly thank the other
11 federal financial regulators who provided some very
12 valuable feedback on this issue for us, especially the
13 Securities and Exchange Commission and the FDIC.

14 Title 9 of the Dodd-Frank Act, as you know,
15 included findings that credit ratings are of systemic
16 importance. And it also found that, in the recent
17 financial crisis, inaccurate credit ratings contributed
18 significantly to the mismanagement of risks by
financial
19 institutions and by investors. As a result, Congress
20 found that increased accountability on the part of
credit
21 agencies is necessary.

22 Title 9 contains several provisions that
are

1 designed to improve the accountability of credit rating
2 agencies including Section 939A.

3 939A requires all federal agencies to do
4 three things: All federal agencies are required to
5 review the regulations for any assessment of the
6 credit-worthiness of the security or money market
7 instrument and your reliance on that kind of
assessment.

8 It requires that all federal agencies to
9 remove those references and replace them with the
10 substitute standard that the agencies deem as
11 appropriate.

12 And the third requires a report to Congress
13 at the end of that process.

14 Upon completing our required review of our
15 relations, we found five instances that contained
16 reference to credit ratings in relation to financial
17 instruments. I will briefly identify the regulations
18 that we are proposing to remove those references to
19 credit ratings and the substitute standards that we're
20 proposing along with those.

21 First, our required review identified two
22 regulations that addressed in what foreign depositories

44

1 future commission merchants and designated clearing
2 organization may place customer funds.

in

3 Commission regulation 30.7 and 1.49
4 currently permit FCMS or DCOs to place customer funds

two

5 foreign depositories that holds either in excess of \$1
6 billion of regulatory capital or whose commercial paper
7 or long-term debt instruments is rated in one of the
8 highest rated categories by at least one credit rating
9 agency. We are proposing to amend both of those
10 regulations in concert albeit in two separate
11 rulemakings.

12 Jon is going to be discussing another
13 proposal related to Commission Regulation 30.7 shortly.

standard

14 Our proposal for 1.49 includes removing the
15 reference to credit rating and substituting the
16 the foreign depositories must hold in \$1 billion in
17 regulatory capital.

to

18 The proposal also requests comments
19 specifically on whether a leverage ratio or capital
20 adequacy ratio requirement consistent with or similar
21 the standards that have been included in the recent
22 accords would be an appropriate additional standard to

45

1 include in our regulations.

2 Next, our review identified a third
3 regulation that referenced credit ratings for financial
4 instruments.

Commodity
interest

5 Commission Regulation 4.24 requires
6 Pool Operators to disclose the type of commodity
7 or other interest in which the pool will be trading,
8 including by disclosing the investment rating of the
9 pool's interest.

10 We are proposing to remove the reference to
11 investment ratings for 4.24 and replace it with the
12 phrase "credit-worthiness." The proposal requests
13 comment on this alternative standard.

as

reference

14 Finally, the last two regulations that we
15 identify that contain some reference to credit rating
16 they relate to financial institutions or financial
17 instruments -- sorry -- will no longer make any
18 to credit-worthiness due to other unrelated proposed
19 amendments that we are going to be noticing in other
20 proposed rulemakings.

21 As we mentioned a couple of times, Jon
22 DeBord will be discussing the wholesale amendments to

46

1 Regulation 1.25 that the staff is going to proposing.
2 And as a result of those amendments, those proposals,
3 there will no longer be any need to reference credit
4 rating in Commission Regulation 1.25.

word

5 Similarly, the proposal that Bella just
6 walked through on Part 40 contained reference to the
7 "rating" in Appendix A Guideline 1 as a way to help
8 disclose the characteristics of the certain contracts
9 listed on DCMs.

in

10 Because Part 40, the Appendix say that Part
11 40 will be removed in its entity by Bella's proposal,
12 also don't have to make any changes to that regulation

answer

13 this proposal. Thank you. And I will be happy to
14 any questions you have.

15 CHAIRMAN GENSLE: Thank you very much,
16 Adrienne. With that, I would entertain a motion.

17 COMMISSIONER SOMMERS: So moved.

18 COMMISSIONER O'MALIA: Second.

been

19 CHAIRMAN GENSLE: And then I just have one
20 question because I keep thinking there were seven
21 references and you referred to five, so my math has
22 faulty today.

47

1 MS. JOVES: You were correct that there
2 were seven total references. So all of our regulations
3 that talked about any reference to credit rating.
4 Dodd-Frank required us to look for assessments of
5 credit-worthiness related securities or money market
6 instruments. There were only five references in our
7 regulation that talked about the financial investments
or
8 those types of things.

9 CHAIRMAN GENSLER: I see. And between
your
10 proposed rule and Jon's proposed rule and maybe the
Part
11 40 rule that we just voted on, do we address all seven
or
12 just five?

13 MS. JOVES: We addressed five.

14 CHAIRMAN GENSLER: So there are two that
15 we're not actually addressing?

16 MS. JOVES: The two that we're not
addressing
17 are related to the credit-worthiness of counter parties
18 and not relating to the types of investment vehicles or
19 those kind of things, which is required under Dodd-
Frank.

20 CHAIRMAN GENSLER: I see. So the math
21 again is there are seven references, but through these

22 three different rules today, we're addressing the five

48

1 that the Dodd-Frank Act requires?

2 MS. JOVES: That's correct.

3 CHAIRMAN GENSLER: Thank you.
Commissioner

4 Dunn?

5 COMMISSIONER DUNN: I have no questions
on

6 this.

7 CHAIRMAN GENSLER: Thank you. Seeing
that

8 there are no further questions, and I will throw a
little

9 statement in the Federal Register why I support it. If
I

10 can could hear all those in favor say "Aye"?

11 (Chorus of ayes.)

12 CHAIRMAN GENSLER: Any opposed? The ayes
13 being unanimous, we will send yours along to Federal
14 Register, as well, for public comment. How many days
for

15 public comment is yours?

16 MS. JOVES: We have a 30-day public
comment

17 period.

18 CHAIRMAN GENSLER: On the first one it
was

19 probably 60. So the first one was 60 days public

20 comment. Thank you.

21 With that, we're going to move forward to
22 the next rulemaking. So John you can come up. I
expect

49

will 1 there will be a few more questions on this one. Jon
2 be ably supported by his boss or his boss' boss Phyllis
Rules 3 Dietz, who was also the team leader on the Clearing
4 and Ananda Radhakishnan, who runs the whole Clearing an
5 Intermediary Oversight Division. Jon?

DeBord 6 MR. DEBORD: Good morning. I'm Jon
Commission 7 with DCIO. I'm pleased to recommend that the
8 approve the publication in the Federal Register, the
9 Federal Register notice questioning public comment for
10 rules opposing, for proposed rules regarding investment
11 customer funds and secured funds of Regulation 1.25 and
12 30.7. I will go over the background of the rule and
then
13 an overview of the proposal and then take any
questions.

14 Under Section 4(d)(a)(2) of the Commodity
15 Exchange Act, customer segregated funds may be invested
16 in the obligations of the United States and obligations
17 fully guaranteed as the principal and interest by the
18 United States such as treasuries and general
obligations
19 of any State or any political subdivision thereof.
20 Municipal securities. In December 2000 and

Regulation 21 again in 2004 and 2005, the Commission amended

as 22 1.25 to include additional permitted investments such

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notes
money
of
and
as
more
we
volatility.

1 GSE Securities, CDs, commercial paper, corporate 1
2 and bonds, foreign sovereign debt, and interest in
3 market mutual funds.
4 Our amendments also include additional
5 safeguards such as credit ratings requirements, issue
6 base concentration limits, or requirement that all
7 investments be readily marketable and sufficiently
8 liquid. Amendments regarding new purchase agreements
9 certain requirements regarding in-house transactions,
10 well as other changes.
11 In 2007 DCIO wants to review to learn
12 about the nature and extent by FCMs and DCOs. It was
13 voluntary. We received an overwhelming response from
14 FCMs that were very helpful. It helped shape our views
15 as lead to our proposal.
16 As we were wrapping up 2008 that review,
17 experienced a financial crisis. This also helped shape
18 our views on the safety and liquidity of certain
19 permitted investments during times of market
20 In May of 2009, the Commission issued a

21 name regarding this topic seeking public comment

22 regarding regulatory requirements that might better

51

1 safeguard customer funds. We received 12 comment
letters
2 and reviewed them and relied on them as well to
formulate
3 our proposal.

4 As noted, this is not technically a
5 Dodd-Frank rulemaking. However, this is a link to
6 Dodd-Frank. And as Adrienne mentioned, which is the
7 Section 939A required the review and removal of credit
8 rating. She mentioned several credit ratings appear in
9 1.25 and 30.7. That's the background.

10 Our proposal is as follows: First, I
will
11 run through the list of permitted investments.
12 First, we're proposing no changes to treasuries. We'll
13 be leaving them safe as liquid and we're not going to
14 limit them in the proposal.

15 We propose that municipals remain a
committed
16 investment. However, due to liquidity and volatility
17 concerns, we are recommending proposing a 10 percent
18 asset-based concentration limit. That means that an
FCM
19 can invest the maximum of 10 percent of their total
20 assets in segregation municipals.

21 Third, GSE Securities. Currently, the
term

22 "GSE Securities" incorporates two different types of

52

an 1 entities. The first is the GSE, which is a privately
2 owned and operated entity chartered by Congress. It has
3 implicit guarantee of the federal government; examples
4 might be Fannie Mae Freddie Mack.

5 Second, public agency -- I'm sorry. U.S.
6 Agency. U.S. Agency is an entity of the Federal
7 Government. It has explicit guarantee. We're prosing
to 8 limit written investments into just U.S. Agency
9 obligations in the second type. We're also proposing a
10 50 percent asset-based concentration for those
11 investments.

that 12 CDs. A CD is another investment type
13 include for our purposes two categories that we will
14 distinguish between. The first is non-brokerage CDs.
15 The second is brokerage CDs.

typically 16 Non-brokerage CDs is what people
17 think of when they think of a CD. An FCM purchased
from 18 the bank. A CD has a maturity date that the FCM wants
to 19 redeem early, it simply goes to the bank and redeems
it. 20 Any penalty is limited to a penalty involved in the
21 interest.

22

An non-broker CD in my opinion is a very

53

a 1 different instrument. It's purchased on large size by
2 broker and sliced up and sold individually to
purchasers.

3 If the purchaser chooses to redeem early,
4 it cannot go directly to the bank. Its only option is
to
5 go into the secondary market, which can often be
6 illiquid.

7 Therefore, we're proposing to limit CDs
to
8 just non-brokerage CD's. We're also proposing a 25
9 percent asset-based concentration limit to that
10 investment.

11 Commercial paper, corporate notes and
bonds,
12 we're proposing to limit those to only commercial paper
13 and corporate notes and bonds that are guaranteed by
the
14 Temporary Liquidity Guarantee Program as administered
the
15 by the FTIC.

16 Commercial paper, we're proposing a
17 commercial paper having a 25 percent asset-based
18 concentration limit. We're also proposing that
corporate
19 notes and bonds up to 25 percent asset-based
20 concentration.

21 We're also proposing to eliminate foreign
22 sovereign debt. First, over the last few years its

54

second, 1 experienced certain instances of volatility. And

2 it's been negligently used by instruments by FCMs.

3 Eight. Money market mutual funds. We're

4 proposing to maintain money market mutual funds

liquidity 5 investment 1.25. However, due to the safe and

6 certain during periods of market volatility, we're

7 proposing a 10 percent asset-based concentration limit.

8 We're also proposing a two percent

9 issuer-based concentration limit for families of funds.

10 Additionally, filing of those permitted

commercial 11 investments, CD's, corporate notes and bonds,

12 paper, municipals -- is that five? And GSE agencies

all 13 have certain requirements regarding credit ratings. As

14 Adrienne mentioned, we're proposing to eliminate all of

15 those.

16 A few other notes regard 1.25. We're

17 proposing to eliminate in-house transactions.

18 We're proposing to eliminate the purchase

19 agreements with affiliates.

20 We're proposing a five percent

counterparty 21 concentration limit for repurchase agreements. The

22 situation we're trying to avoid there is where a FCM

55

1 re-certification or repurchase agreement takes a 100
2 percent of its cash into a repo and then the
counterparty
3 default. This will limit that to a five percent
4 counterparty concentration. So we have a safeguard
5 against that situation. The additional technical
6 amendments to 1.25 I can discuss if you want me to.

7 30.7 regards customers investing in
foreign
8 futures. Currently, there's not an enumerated list of
9 investments that customer are limited to rather than
10 saying a more general obligation to investment in only
11 liquid investments that are submitted to meet
obligations
12 to customer. We're proposing today to limit 30.7 funds
13 to the investment limitations of 1.25.

14 We're also, as Adrienne mentioned, are
15 proposing to eliminate references to credit agreements
16 along with a couple of other amendments to 30.7.

17 This concludes the overview. Thank you. I
18 will be happy to answer any question.

19 MR. RADHAKISHNAN: Just to add one point.
20 1.25 goes to what a FCM and a DCO can do. Once it gets
21 money or securities from a customer, what are you
allowed
22 to do with the assets that you get from the customer.

56

1 1.25 does not go towards what an FCM can take of its
2 customers. That is usually guided by Exchange rules.

3 For example, the CME, for example, has a
rule

4 that it direct to its member FCM as to what they can
5 accept from its customers. So I want to make sure this
6 information is once you get the money in, what can you
7 do.

8 CHAIRMAN GENSLER: Thank you Jon and Ananda
9 and Phyllis for supporting it. With that, I will
10 entertain a motion to accept the staff's
recommendations.

11 COMMISSIONER SOMMERS: So moved.

12 COMMISSIONER CHILTON: Second.

13 CHAIRMAN GENSLER: With that, there are
some
14 discussions. Ananda, as I under it, this is only if
that

15 futures commission merchant or the clearing
organization
16 takes cash, what he can do with the cash. Is that what
17 you're saying?

18 MR. RADHAKISHNAN: Either cash or any other
19 type of collateral that it allow to accept. For
example,
20 a customer may give treasuries to an FCM. We're
21 proposing to allow them to engage in reversals in doing

22 repos.

57

allows
this

do

well,

what

that's

1 CHAIRMAN GENSLER: But if the Exchange
2 them to take what I will a non-permitted asset here,
3 rule will not force them?
4 MR. RADHAKISHNAN: Correct. It will not.
5 CHAIRMAN GENSLER: They can do that?
6 MR. RADHAKISHNAN: Sure.
7 CHAIRMAN GENSLER: If the Exchange says you
8 can take municipals or corporate --
9 MR. RADHAKISHNAN: Correct.
10 CHAIRMAN GENSLER: -- or money market funds
11 created in 10 percent --
12 MR. RADHAKISHNAN: Correct.
13 CHAIRMAN GENSLER: -- they can continue to
14 that?
15 MR. RADHAKISHNAN: Correct.
16 CHAIRMAN GENSLER: This is basically --
17 what do you with it?
18 MR. RADHAKISHNAN: Once you bring it in,
19 can you do with it. Once the FCMS accepts something.
20 CHAIRMAN GENSLER: Right. Basically,
21 cash, then?

22

MR. RADHAKISHNAN: Yes.

58

Jon 1 CHAIRMAN GENSLER: The other question for
it 2 as I understand maybe it's five -- I might be counting
there 3 wrong. I've been counting poorly today -- but that
address 4 may have been four or five areas where we had to
5 this because it relates to ratings, rating agencies in
how 6 sovereign debt, rating agencies from municipals, that
7 we find ourselves in this position. Is that correct?

8 MR. DEBORD: That is correct.

like 9 CHAIRMAN GENSLER: And in some instances
10 sovereign, you say there's such negligible use of it
11 occurring, we don't have a ready alternative to
ratings.

12 MR. RADHAKISHNAN: Right. And the other
13 issue with sovereign is you have two risks. You've got
14 liquidity risks and the currency risk, as well.

15 CHAIRMAN GENSLER: Nonetheless, we don't
have 16 a good alternative.

17 MR. RADHAKISHNAN: Correct. We don't.

18 CHAIRMAN GENSLER: Your staff
recommendation 19 is that it's not used that much?

20 MR. RADHAKISHNAN: Correct.

21 CHAIRMAN GENSLER: But then getting to an
22 area where Commissioner O'Malia spoke to and I'm

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1 supportive of this proposal -- and it's just that, a
2 proposal -- but I think the public should commence on
it.

3 Why did you decide to limit money market funds to 10
4 percent that Commissioner O'Malia raised?

5 MR. RADHAKISHNAN: Our big concern was with
a
6 significant money market fund or reserve fund broke the
7 bank. That was described in government money market
8 fund. But, as we found out, funds that are described
as
9 government money market funds do not necessarily have
to
10 invest all of their money in government securities. So
11 that fund had significant holdings of Lehman commercial
12 paper.

13 One our rules said that if you want to be a
14 money market that wants to participate in our program,
15 you've got to allow for next-day redemption. The SEC
16 rules allow for seven-day redemptions. But we say
that's
17 nice. If you want to participate in our rule, you must
18 allow for next-day redemption and you're offering
19 documents have to show that.

20 Two things happened. That fund broke the
21 bank and applied to the SEC for a waiver of the next-
day

22 redemption. In fact, the SEC I think said you don't
have

60

1 to redeem it.

FCMs

2 So we were left with the situation where

when

3 had significant investments in that particular money

4 market fund. And there was a lot of confusion as to

5 that fund was able to return money to customers.

going

6 We were working on a daily basis with staff

7 of the SEC to find out the answer to when is this fund

8 going to pay the customer back, and how much is it

9 to pay back.

the

10 As I said before, I guess in this was an

11 issue that hadn't confronted the SEC staff for so some

12 time. So there was a lot of confusion. It was clear

not

13 value of the fund was not zero. That asset value was

14 zero because they had a lot of investments. The issue

15 was what was the value and when did you realize it.

decisions

16 And, eventually, we began to make

redemption

17 as to how to value that fund. And we issued a

18 letter. Basically, a graduating scale downward toward

19 where we said after a particular point in time value it

20 90 cents to the dollar.

21 And that was based on the value, the market

22 value of investments the fund did have, which were not

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rest 1 under water. The Lehman stuff, zero value. But the
 2 of the stuff, it was sold. Finally, there was a
on 3 resolution. And I think people got more than 90 cents
 4 the dollar.

 5 But the object of the story is: Once what
 6 people thought were very safe investments are not
 7 necessarily so. And, to our knowledge, there is no
 8 government guarantee. There is a Temporary Grantee
are 9 Program for money market funds. But to this day, we
 10 not aware of any money market fund that has a guarantee
 11 of that name.

 12 So basically we want to make sure that --
customer 13 these are investments that other people make for
 14 money. I think that needs to be born in mind. This is
 15 not what the customer tell you to do. This is what the
 16 FCM and the DCOs does with customer funds. And our
 17 regulations permit FCMs and DCOs to keep the spread.
 18 They're not obliged to give their earnings back to the
 19 customer. So we want to make sure that investments are
 20 of customer money are made very safe. And that's why
 21 we're proposing the limitation to on money market
funds. 22

 MS. DIETZ: I would also just add, putting

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1 this into a broader context, there is an overarching
2 requirement that the FCM or DCO investment be objective
3 of preserving principal and maintaining liquidity.

4 And, technically, the reserve primary fund
5 met all of the requirements of 1.25. It had next-day
6 redemption. It was a 2(a)(7) fund. There was nothing
7 wrong with the investment. But, as it turns out, it
8 didn't meet the overarching requirements.

9 And liquidity is particularly important,
and
10 we just made a judgment as to what we thought an
11 appropriate threshold would be for what we now
understand
12 to be the nature and characteristics of money market
13 mutual funds at this point.

14 CHAIRMAN GENSLER: I think that you
included
15 -- we have documents, but you included it. I can't
find
16 it. Do we have a specific set the questions about
money
17 market funds? We way we request comments on money
market
18 funds investments should be limited to treasuries or
19 those, et cetera , et cetera. But do we actually,
20 specifically ask about this 10 percent limit?

21 MS. DIETZ: Yes.

22

CHAIRMAN GENSLER: We do. Okay. We do. I

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1 have one other question that came up. And I didn't
2 follow the discussions on GSEs. I understand that GSEs
3 are not guaranteed by the government and all that. But
4 what is the limit that in the rule? And maybe this is
5 off of Commissioner O'Malia's question, but what are we
6 say specifically on GSEs?

limit

7 MR. DEBORD: Do you have the asset-based
8 concentration limit? The asset-based concentration
9 for U.S. Agency obligation is 50 percent. There's
10 already --

11 CHAIRMAN GENSLER: Five zero?

25

12 MR. DEBORD: Five zero. There's already a
13 percent issuer-based limitation. So, at most, an FCN
14 have two 25 percent investments totaling 50 percent in
15 U.S. Agency obligations.

can

16 CHAIRMAN GENSLER: So it's not we have a 50
17 percent limitation, it's just that you're saying that
18 have a 25 percent limit because there's two, Fannie Mae
19 Freddie Mac?

we

20 MR. RADHAKISHNAN: No. That's not true. We
21 actually proposing a 50 percent limit. Right now under
22 the current law there is no limit. So 100 percent of

64

1 your investments can be in GSEs.
2 We're proposing two things: These
entities,
3 GSE government corporations, they must be fully,
4 explicitly backed, by the Full Faith & Credit Act of
5 United States.

6 CHAIRMAN GENSLER: But they're not.

7 MR. RADHAKISHNAN: That is right. There is
8 one.

9 MR. DEBORD: The important distinction
10 between GSEs and their private entities and U.S.
11 agencies, which ae entities for the Federal Government.
12 The first is having implicit backing of the United
13 States. So Fannie Mae and Freddie Mac are not actually
14 explicitly guaranteed.

15 U.S. agencies like Ginnie Mae, small
business
16 administration are federal entities. They are
explicitly
17 backed by the Full Faith & Credit Rating by the United
18 States. That's the distinction that we made. On top
of
19 that we add 50 percent asset-backed concentration limit
20 and a 25 percent issuer-based limit
21 So, Commissioner O'Malia -- if we're
22 allowed to deliberate -- you're thinking it should be

65

1 less than 50 percent, just so I can learn more here?

2 COMMISSIONER O'MALIA: No. I think these

3 rules are overly prescriptive. We have a limit of 10

4 percent on money markets. We have a 50 percent limit

on

5 these GSEs, but one only GSE actually qualifies. So

6 we're putting -- you're allowed to put 50 percent of

your

7 money into one entity based on Ginnie Mae, I believe.

8 MR. RADHAKISHNAN: True. But on the flip

9 side, that entity is explicitly backed by the Full

Faith

10 & Credit of United States Government.

11 COMMISSIONER O'MALIA: Why don't we just

put

12 it all in treasuries and Ginnie Mae and just get over

it.

13 Money markets are, you know, I'm concerned that you're

14 saying that money markets are not some place where

people

15 should not put their money anymore.

16 MR. RADHAKISHNAN: I don't think that we

are

17 saying that. I think what we are saying is that --

18 COMMISSIONER O'MALIA: This may be news to

19 the Fed, by the way.

20 MR. RADHAKISHNAN: I think what we're

saying

21 is want you want to do with your money is your
business.

22 But if you're investing other people's money, it should

66

time 1 be safe. That's the overarching message because the
2 when you need it the most, as we saw in 2008, you know,
3 there's a flight to equality, and that's that where you
4 have issues. Tether

FCM 5 We want to make sure that in a time when
6 or a DCO needs to get access to -- and this is
7 essentially marginal -- that there be no instances in
8 which untethered access to liquid assets, that there's
a 9 minimalization as to when there is a barrier.

I 10 CHAIRMAN GENSLER: So, as I understand it,
11 find myself -- I mean, I'm voting for this rule. I
sense 12 you might not be. But it's a proposal, and we'll get
13 comments. Is that I'm very interested on the public
view 14 on this 10 percent. It's really that which, the GSE
15 thing, now that we've clarified it, that Ginnie Mae can
16 be up to half of that portfolio?

17 MR. RADHAKISHNAN: Right.

18 CHAIRMAN GENSLER: That's not Fannie and
19 Freddie?

20 MR. RADHAKISHNAN: No. It's not Fannie and
21 Freddie because Fannie and Freddie are not explicitly

22 guaranteed. Now, the reason we left a reference to
GSE,

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may 1 there might be in the future, the Federal Government
2 explicitly back the dead instrument.

3 CHAIRMAN GENSLER: But they haven't now.

4 MR. RADHAKISHNAN: But they haven't now.

5 That's right. And we admit that.

6 CHAIRMAN GENSLER: Phyllis?

a 7 MS. DIETZ: I would just like to clarify on

8 couple of points. As far as GSEs, Government Sponsored
9 Enterprises, that was a term that we use and use

Fannie 10 currently. And we have become aware now since the

11 and Freddie problems that there are two different types
12 of agency securities, as Jon mentioned.

13 There are U.S. government corporations like
14 Ginnie Mae. And then there are technically GSEs that
are 15 Fannies and Freddie's. But there's actually -- and I

16 believe its Title 31 -- an enumerated list of U.S.
17 government corporations. And the idea is there is a 50
18 percent limit on U.S. government agencies, what we're
19 calling agency securities that are backed by the Full
20 Faith & Credit of the U.S.

Mae 21 So as an opposite, that's only the Ginnie

22 type corporations, but we include within the definition

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1 of GSE. So at such time we don't have an implicit, but
2 an explicit guarantee, if that should happen, those
would
3 be encompassed within our regulation. We don't have to
4 go back and amendment it.

5 There is, however, a 25 percent issuer-
based
6 concentration limit and today we're not changing that.
7 So indeed even though up to 50 percent of a portfolio
of
8 total assets segregation could be in these government
9 agencies securities only 25 percent of total assets can
10 be in securities of one issuer.

11 So there are different types of
concentration
12 limits: There's issuer-based and that which goes to
13 credit risk. And then there is asset-based or
14 instrument-based which goes to the category of the
15 investment.

16 So, for example, with money market mutual
17 funds, there is a 10 percent asset-based limit, which
18 would apply to total assets and say, you know, any
money
19 market mutual fund. And then there is a two percent
20 issuer-based limit related to family of funds.

21 CHAIRMAN GENSLER: I think I understand
now.

22 I'm supporting the rule. I think Commissioner Dunn

69

1 sometimes says that it's more liberal when you're
2 supporting proposals.

3 I think this is a necessary rule because of
4 the credit rating piece. There's like if five or six
5 place that we have to, in essence, clean up 1.25 for
that
6 reason.

7 In addition, I think it's appropriate to
8 address ourselves to what happened if the 2008 crisis
9 around Government Sponsored Enterprises and money
market
10 funds. My question is similar to Commission O'Malia
11 rather 10 percent is too tight. But we will hear from
12 the public. Commissioner Dunn?

13 COMMISSIONER DUNN: Thank you, Mr.
Chairman.

14 I think that safeguarding customer funds is one of the
15 basic functions of the Commodity Futures Trading
16 Commission. I applaud the staff for their actions in
17 this area. I have some concerns very similar to
18 Commissioner O'Malia on the limitations.

19 And I'm wondering, Jon, do we have an idea
of
20 how much is currently invested this these various
21 categories?

22 MR. DEBORD: Our 2007 survey address that;

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1 although it's been three years since then. Certainly,
2 there's some that have been used.

barely

3 As I mentioned, foreign sovereign debt
4 used it all. It seems like treasuries and money market
5 funds were the two largest categories. And then,
6 frankly, not very much in municipals, minimal amounts
7 commercial paper and corporate notes.

in

8 I think just from, antidotally, I think
9 there's a larger percentage in CDs now than there was a
10 few years ago. That's just antidotal, so I don't have
11 set figures, just my impression.

not

12 MR. RADHAKISHNAN: Basically, cash, money
13 market fund, and some agencies. But the others were
14 that heavily used.

15 COMMISSIONER DUNN: But it's very difficult
16 for us to determine if these are high or low or just
17 right because we don't really have a handle how much
18 you're currently invested in these various assets
19 classes.

the

20 One other thing I'd like to bring out are
21 GSEs. Two GSEs that are very near and dear to my heart
22 Farmer Mac and the Farm Credit System. It's my

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they 1 understanding if we adopt this proposed rule as is,
2 would not be eligible classes for investment.

debt. 3 MR. RADHAKISHNAN: They're not if their

& 4 If the issue is not explicitly backed by the Full Faith
5 Credit of the United States, then they would not be
6 eligible.

there 7 Again, for municipalities and others
8 is this fold in the realm of unintended consequences.

I 9 would hope that the commentary on here give us some
type 10 of insight as to what the effect of that this proposed
11 rule is on.

proposed 12 As the Chairman said, I'm liberal on
comments 13 rules. I look forward for the public to give us
direct 14 and the industry to give us comments to help us to
15 these financial rules that will make sure that we
16 safeguard the customer funds because I think that's
17 paramount. But to make sure that we're not doing
18 something else that will have some impact that would
not 19 like to follow. Thank you.

about 20 CHAIRMAN GENSLER: I think Phyllis was

21 to speak.

22 MS. DIETZ: Yes. I want to add that -- I'm

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advanced 1 looking through my draft now. But we did do the
2 notice of proposed rulemaking, so we did get some more
the 3 up-to-date data. I think that the consensus was that
4 investments were mostly in treasuries and money market
do 5 mutual funds. I can't find my place right now, but we
6 have we some more up-to-date data.

7 Also, the survey that we did at the end of
8 2007 I think is still useful in that it reflects a more
9 normal and stable market situation. So there were
10 dramatic changes of course after September 2008. And,
11 presumably, slowly but surely, people are resuming
normal 12 investment practices.

13 So I think that even though we don't have,
14 you know, empirical data as of today, I think we have a
15 pretty good sense based on our survey, based on the
16 comments we've got from the ANOPR, and based on filings
17 that we get from our FCM registrants, and questions
also 18 that I get informally; phone calls asking questions
about 19 permitted investments. So we have a pretty good idea
in 20 what people are investing in.

21 CHAIRMAN GENSLER: Commissioner Sommers?

22

COMMISSIONER SOMMERS: Thank you, Mr.

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1 Chairman. I have a question with regard to what I
2 understand may have been a change in Second 627 of
3 Dodd-Frank to remove the prohibition on payments of
4 interest on demand deposits.

impact

5 And I was just wondering what kind of
6 that change may have had on decisions that you made for
7 what is permitted or not permitted in the future.

did

8 MR. RADHAKISHNAN: I think certainly that
9 have a variance. That did have some influence because
10 historically the reason why nobody thought to cash
11 because you couldn't get interest, because we said when
12 you bought cash, it has to be in a demand-deposit
13 account. And there was a prohibition against paying
14 interest on a demand-deposit accounts.

allowance

15 So if we see as a result of 627 the
16 in, commercial banks paying interest on demand-deposit
17 accounts, you might see a move to money being put in
18 demand-deposit accounts; although, given the interest
19 that's currently being paid on demand-department
20 accounts, there may be some sort of reluctance. But
21 certainly would have a varying.

that

after

22 For example, if you look at in the U.K.

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1 Lehman, there was huge move to toward cash. And in the
2 U.K. they've never had this prohibition.

staff

3 At one point, the London Clearing House
4 told me that they had 25 billion euro in cash because
5 people were not trusting any other form of instrument.
6 Now, that's change since then, so there might be a move
7 towards cash.

deposit

that

8 COMMISSIONER SOMMERS: I guess my question
9 was more as to whether demand, interest on demand-
10 accounts could be seen as a substitute for anything
11 we are now prohibiting.

you

pay

people

12 RADHAKISHNAN: It could be. It could be.
13 And I don't think so because I think if you look at
14 interest rates -- may be substituted for CD's because
15 don't have, you know, assuming that a CD had a penalty
16 for every withdrawal of interest, so people might put
17 more in a demand-deposit account instead of CDs. But I
18 believe historically, the other instrument tended to
19 a better rate of return than demand fund accounts.
20 But, on the other hand, there might be
21 because they perceived, because of liquidity and safety

22 demand, don't put money into that account.

75

other

if

done

that's

in

1 COMMISSIONER SOMMERS: I just have one
2 question. The chart that you're working of, is this
3 included in the proposed rule? I guess I'm wondering
4 it could be posted with the proposed rule.

5 MR. RADHAKISHNAN: We actually had just
6 that as an aid for the Commissioners.

7 COMMISSIONER SOMMERS: I think it's really
8 helpful.

9 MR. RADHAKISHNAN: We can put it on the
10 website. Sure. Sure.

11 COMMISSIONER SOMMERS: Thank you.

12 CHAIRMAN GENSLER: Thank you. I think
13 a good suggestion on putting that on the website.
14 Commissioner Chilton?

15 COMMISSIONER CHILTON: I don't have any
16 questions. Thank you.

17 CHAIRMAN GENSLER: Commissioner O'Malia,
18 adding to our colloquies?

19 COMMISSIONER O'MALIA: For us growing up on
20 farm there's an old saying there's no second education
21 kick of a mule. Or, there's no education in the second
22 kick of a mule, actually.

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rulemaking

1 I'm a little frustrated with this

2 because we did do an advanced notice proposal. And we

Put

3 did receive comments that said put it in treasuries.

4 it in money markets and we completely ignored that.

5 I think that if we've done anything, I hope

6 that Dodd-Frank has at least restored some stability to

7 our banking system and the financial integrity therein.

was

8 And I do believe that your analogy on it is fine. It

9 a real concern. That was a problem. That was a

10 breakdown if our financial system.

11 After 2000 pages of Dodd-Frank, I hope we

12 fixed that. And I think we should be able to put money

13 back. And I think we ought to raise these numbers

14 significantly. And I'm just going to leave it at that.

15 CHAIRMAN GENSLE: If I might. I can't

16 remember our procedures. I would like to propose one

17 amendment and see if I have support. But it's an

18 amendment to have an explicit question because I just

question

19 can't find it on Page 17. But have an explicit

20 about the 10 percent limit money market funds. And to

21 have a variation on it to say; one, is this appropriate

22 level given the events of 2008 and the passage of

77

1 Dodd-Frank. And second, if not, what other level might
2 be appropriate. And thirdly, that if it was a higher
3 level, might there be limits per issuer.

4 MR. RADHAKISHNAN: Issuer-based.

5 CHAIRMAN GENSLER: Issuer-based.

6 MR. RADHAKISHNAN: So what would be the
7 appropriate number?

8 CHAIRMAN GENSLER: Yes. Yes. If there's
9 some other number other than 10 percent, maybe there's
10 some set of issuer-based. So I'd like to offer that as
11 an amendment. It's really just questions but important
12 questions. I think I have to see whether there's a
13 second to my amendment.

14 COMMISSIONER O'MALIA: Second.

15 CHAIRMAN GENSLER: So I will take a vote on
16 the amendment and then I'll take a vote on the
underlying
17 rules. So first we'll take on the amendment. All aye?

18 (Chorus of ayes.)

19 CHAIRMAN GENSLER: Any Opposed? And now on
20 the underlying rule as amended. All in favor say
"Aye."

21 (Chorus of ayes.)

22 CHAIRMAN GENSLER: Any opposed?

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1 COMMISSIONER O'MALIA: Naye.

2 CHAIRMAN GENSLER: I think it's 4-1 on the
3 proposal sending it to the Federal Register as amended
4 and I thank you all. And this is very helpful. The
5 debate is very helpful, too. I thank you Phyllis and

Jon

6 and Ananda.

7 And now I think we're turning the fourth

rule

8 set. Eileen Donovan of the Clearing Intermediary

9 Oversight will now present proposed rules on the

propose

10 for swaps to be determined to be mandatory clearing.

11 MS. DONOVAN: Good morning.

12 CHAIRMAN GENSLER: Good morning, Eileen and

13 Ananda.

14 MS. DONOVAN: The staff is recommending

that

15 the Commission approve for publication in the Federal

16 Register a notice of proposed ruling on the process for

17 reviews of swaps for mandatory clearing.

18 The rulemaking is divided into four parts.

19 The first part concerns the eligibility of a DCO to

clear

20 swaps. Section 745(b) of the Dodd-Frank Act directs

the

21 Commission to put to criteria conditions over rules

under

22 which the Commission will determine initial eligibility

79

1 or continuing qualification of DCO to clear swaps.

2 Under the proposed rule, a DCO will be

3 presumed eligible to accept for clearing any swap that
is

4 within a group, category, or type or class of swaps
that

5 the DCO already clears.

6 The DCO that plans to accept for clearing
any

7 swap that is not within a group category, type, or
class

8 of swaps that the DCO already clears would be required
to

9 request a determination by the Commission of its

10 eligibility to clear the swap.

11 To receive such a determination, a DCO
would

12 have to file a written request with the Commission that

13 addresses its abilities to maintain compliance with the

14 DCO core principles if it accepts the swap for
clearing.

15 In particularly, the sufficiency of its

16 financial resources and its ability to imagine the
risks

17 associated with clearing the swap, especially if the

18 Commission determines that the swap is required to be

19 cleared.

20 The second part of the rulemaking concerns

21 submission of swaps to the Commission. Section
22 7(23)(a)(3) of the Dodd-Frank Act provides that it
shall

80

1 be unlawful for any person to engage in a swap unless
2 that person that submitted such swap for clearing to a
3 DCO that is registered under the CEA or a DCO that is
4 exempt from registration under the CEA if the swap is
5 required to be cleared.

6 Section 723(a)(3) requires the Commission
to
7 adopt the rules for the review of the swap group,
8 category, type, or class of swaps to make a
determination
9 as to whether the swaps should be required to be
cleared.

10 The proposed rule requiring the DCOs
11 submitting swaps to the Commission to provide certain
12 information to assist the Commission in its review
13 including a statement that addresses the five specific
14 factors that the Dodd-Frank Act requires the Commission
15 to take into account when reviewing swaps for
submission.

16 Those five factors are: First, the
existence
17 of significant outstanding notional exposures, trading
18 liquidity, and adequate pricing data.

19 Second, the availability of rule framework,
20 capacity, operational expertise and resources, and
credit
21 support infrastructure to clear the contract on terms

trading 22 that are consistent with the materials terms and

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1 conventions on which the contract has been traded.

2 Third, the effect of the mitigation of
3 systemic risk taking into account the size of the
market
4 for such contract and for the resources of the DCO
5 available to clear the contract.

6 Fourth, the effect on completion, including
7 appropriate fees and charges applied to clearing.

8 And, finally, the existence of reasonable
9 legal certainty in the event of the insolvency of the
10 relevant DCO or one or more of the clearing members
with
11 regard to the treatment of customer and swap
counterparty
12 positions, funds, and property.

13 The DCO would also be required to provide a
14 description of the manner in which the DCO provided
15 notice of its members and a summary of any opposition
16 expressed by members.

17 As required by Dodd-Frank, the submission
18 would be posted for a 30-day public comment period.
And
19 the Commission would make its determination no later
than
20 90 days after receiving a complete submission unless
the
21 DCO agrees to an extension.

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1 Commission-Initiated Reviews of Swaps. The Dodd-Frank
2 Act requires the Commission on an ongoing basis to
review
3 swaps that have not been accepted for clearing by a DCO
4 to make a determination as to whether the swaps should
be
5 required to be cleared.

6 If no DCO has is accepted for clearing
swaps
7 that the Commission finds would otherwise be subject to
a
8 clearing requirement, the Commission would investigate
9 the relevant facts and circumstances within 30 days of
10 the completion of its investigation, issue a public
11 report containing the results of the investigation.

12 The Commission would take such actions as
it
13 determines to be necessary and in the public interest,
14 which may include establishment of margin or capital
15 requirements for parties to the swaps.

16 And finally the last part of the rulemaking
17 concerns the Stay of Clearing Requirements. After
making
18 a determination that a swap is required to be cleared,
19 the Commission, on application of a counterparty to a
20 swap or on its own initiative, may stay the clearing
21 requirement until it completes a review of the terms of
a

22 swap and the clearing arrangement.

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it 1 If the Commission decides to issue a stay,
clearing 2 would have 90 days to complete its review of the
 3 of the swap unless the DCO agrees to an extension.

Commission 4 Upon completion of its review, the
 5 could determine, subject to any terms and conditions as
 6 the Commission determines to be appropriate, that the
 7 swap must be cleared, or that the clearing requirement
 8 will not apply but clearing may continue on a non
questions. 9 mandatory basis. Thank you. I will take any

will 10 CHAIRMAN GENSLER: Thank you, Eileen. I
 11 entertain as a motion?.

12 COMMISSIONER SOMMERS: So moved.

13 COMMISSIONER O'MALIA: Second.

14 CHAIRMAN GENSLER: With the motion made and
15 seconded just a couple of question. As I understand,
16 Eileen -- I support this proposal. I think it's very
17 important process rule. But as I understand, we are
18 earlier on under Dodd-Frank asked each of the clearings
19 organizations that currently clear swaps to wait a
little 20 while until their swaps are submitted under this
process

21 from. Can you walk us through, just walk us through
how

22 that relates to the rule?

84

those
to
days

1 MS. DONOVAN: Sure. Under Dodd-Frank,
2 swaps that are already being cleared deemed submitted
3 the Commission for review. So the Commission has 90
4 to review those swaps unless the DCO has agreed to an
5 extension.

6 We requested that all DCOs agreed to an
7 extension. They did agree. So that once these rules
8 become final, which we're hoping will be in April, the
9 Commission could begin its 90 days of those swaps
meaning
made

10 a determination on the varying requirement could be
11 by July, which would be the effective date of the
12 legislation.

13 CHAIRMAN GENSLER: If I remember, I think
14 there were eight or so.

15 MS. DONOVAN: It was eight DCO'S that
16 currently cleared OTC products that may or may not be
17 swapped.

18 CHAIRMAN GENSLER: Again, so those eight
19 clearing organizations under the statute, it was deemed
20 that they were submitted unless they agreed to an
21 extension. They've all agreed to an extension, all
22 eight?

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1 MS. DONOVAN: That's correct.

2 CHAIRMAN GENSLER: And the goal of the
3 staff, one that I endorsed, is that we try to complete
4 this rule before the 360 days, but complete it at 270

or

5 so days by next April 15 tax day. I think it's also
6 Pete's birthday. But by tax day so we can run the 90-
7 process. Is that's what your thinking is?

day

8 MS. DONOVAN: Yes. That's correct.

9 CHAIRMAN GENSLER: Okay. Thank you. I
10 don't have any questions. Commissioner Dunn?

on

11 COMMISSIONER DUNN: I have no questions

12 this. I think the taxing point is that staff and the
13 Commission to be able to do these review.

we

14 CHAIRMAN GENSLER: Commissioner Dunn, I
15 agree with you. In terms of just some of the figures,

discussion

16 don't know how we'll group these. But the largest
17 interest rate swap clearing house LCH in some

18 with them, they have in the interest rate space I think
19 nearly three quarters of a million contracts that they
20 clear. And some of their non-interest rates it adds up
21 to about a million. Is that right?

22 MR. RADHAKISHNAN: Yes. That's correct.

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1 CHAIRMAN GENSLER: Presumably, IT will be
2 grouped by class and so forth. But next spring, we
might
3 be putting out the public comments this nearly three
4 quarters of million interest rate swaps that they
5 currently clear. Hopefully, it will boil down to
6 hopefully dozens of categories. But I share your
views.
7 Without staff, it's going to get clogged up pretty
fast.

8 Commissioner Sommers?
9 COMMISSIONER SOMMERS: Thank you, Mr.
10 Chairman. Just to walk through that type of example
that
11 he used with LCH. LCH or another clearing house that
may
12 want to clear interest rates swaps applies to clear a
13 class of swaps and tells the Commission that they
intend
14 to clear 300,000t different interest rate swaps, what
is
15 the process for that from our point of view?

16 MS. DONOVAN: Well, each of those swaps
have
17 to be submitted. But there is a provision in the rule
18 that requires that they specifically can do so if they
19 group them by class, type, or category. And it also
give

those 20 es the Commission the right under the rule to group
21 appropriately for review.
22 COMMISSIONER SOMMERS: And if they submit

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process 1 them as a group, them from our point of view, the
 2 is to go through 300,000 different interest rate swaps.
are 3 Do we then make a determination that 200,000 of them
 4 okay but 100,000 are not?

5 MR. RADHAKISHNAN: That's possibly. That
6 could be a possible outcome. Although, I would think
7 that, without pre-judging the issue, if clearing houses
8 are already successfully clearing swaps, then we would
9 have, the staff would have to have good reasons to
10 recommend to the Commission that, let's say it was
11 300,000, 200,000, 100,000 either should not be cleared,
12 or there should not be a determination they should be
13 cleared.

14 But, Commission come as you are pointing to
otherwise. 15 the enormity of tasks, and I will not tell you

16 It is an enormous task. It could be that one group is
17 U.S. dollar-based fixed-payment and fixed-flowing. And
the 18 the flowing is liable and the fixed-rate, depends on

19 day, a five-year swap. So that would be easier to
20 evaluate. But we will really know what our task is
once

21 we start investments. Hopefully that the public
comment

22 period will help the Commission help the staff making

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1 recommendations.

2 COMMISSIONER SOMMERS: That was my next
3 question really. For final rules in the this area, do
we
4 expect that there will be more specific information
about
5 exactly what the process is going to be and how,
6 especially in a situation where you may have a clearing
7 house that already clears a million different contracts
8 in interest rates swaps, but a new clearing house that
9 wants to clear the exact same, what's process of
deciding
10 whether or not that new clearing house is eligible, or
11 how do we decide, you know? Will there be more
substance
12 in that final rule?

13 MS. DONOVAN: Well, a new clearing house
that
14 wants to clear would first have to go to the first
part,
15 the review eligibility under 745(b).

16 COMMISSIONER SOMMERS: I guess I was just
17 assuming that a new clearing house that has already
been
18 approved to clear.

19 MR. RADHAKISHNAN: Clear swaps or a new
DCO?
20 I think Eileen is talking about if a DCO has not
started

21 clearing swaps and wants to clear swaps, then it will
22 have to apply to us for eligibility to clear swaps.

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1 So basically they will tell us what does it
2 want to clear. What it's marginal regime is. What the
3 ongoing risk management is. What the default
procedures
4 are. Basically, a demonstration to the Commission that
5 it is qualified to clear and price the swap.

6 COMMISSIONER SOMMERS: So that approval
will
7 be by asset class?

8 MR. RADHAKISHNAN: Yes. It will be by
asset
9 class. It depends on what it wants to clear.

10 COMMISSIONER SOMMERS: I'm sorry, I have
one
11 other question regarding the stay. If you could
explain
12 what a reason would be for a counterparty to apply for
a
13 stay, and what would be a reason that we would grant a
14 stay to the counterparty.

15 MS. DONOVAN: The rule doesn't go to that.
16 We just ask that they provide explanation and why. I'm
17 sure the presumption would be one of those five
factors.

18 But I list that for some reason the Commission's
decision
19 is on any of those factors that the counterparty is
20 disputing the finding on those. We could ask that in
the

21 proposal.

22 It's possible, based on comments we got in

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the 1 response to the proposal that we would define that in
2 final rule.

3 COMMISSIONER SOMMERS: And then the
4 determination approval of that stay would have an
affect 5 on all other swaps of that category? If a particular
6 counterparty applied and said they requested a stay,
that 7 stay would be applicable to that class?

8 MS. DONOVAN: Right. All swaps would fall
9 under that requirement, yes.

10 COMMISSIONER SOMMERS: Thank you.

11 CHAIRMAN GENSLER: Thank you, Commissioner
12 Sommers. I think this highlights -- and I can only
speak 13 for one Commissioner -- I believe that's the only way
14 this is going work is if it's done by class, group, or
15 contracts. There is no way. We don't have the
16 resources, nor does the public through a 30-day period.

17 LCH, for instance, currently clears
interest 18 rate swaps for a group of currencies, and let's say
19 that's 15 or 20 different currencies.

20 Ananda used the example of U.S. dollar
swaps, 21 that they would somewhat submit to us their U.S. dollar

five 22 swap business may be broken down by three or four or

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1 or maybe 10 or 20 categories, but not the hundreds of
2 thousands of contracts.

3 I think that's the only way we can do it.
4 And I think it's the best way for the public to react.
5 But I can't predict how they'll submit it. They could
6 submit next April in a way that we ask them. I think
7 under this rule, we could ask them to re-categorize

this

8 right. This gives us permission to regroup and
9 re-categorize.

10 MR. RADHAKISHNAN: Yes, it does.

11 CHAIRMAN GENSLER: And it's correct that if
12 it were approved for one swap clearing house one

clearing

13 house it relates to others. If there's another

eligible

14 interest rate clearing house they, too, would be able

to

15 do it. Is that right? I mean once you're eligible in
16 that category?

17 MR. RADHAKISHNAN: Once you're eligible in
18 that category, once you've already been approved to

clear

19 the swaps.

20 CHAIRMAN GENSLER: So we're not try to pick
21 amongst them?

22 MR. RADHAKISHNAN: No.

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1 CHAIRMAN GENSLER: Even though Commissioner
2 Sommers -- I'll use as an example -- is trying to pick
3 amongst them?

4 MR. RADHAKISHNAN: Correct.

5 CHAIRMAN GENSLER: Commissioner Chilton?

6 COMMISSIONER CHILTON: I have no questions.

7 CHAIRMAN GENSLER: Not having any further
8 questions, I will call a vote. All in favor?

9 (Chorus of ayes.)

10 CHAIRMAN GENSLER: Any opposed? It being
11 unanimous 5-0. I think, Eileen and Ananda, we'll send
12 off to the Federal Register. And so what do we have
13 next?

14 So we have one proposed rule and one
15 set of questions called "An Advanced Notice of Proposed
16 Rulemaking on Anti-Manipulation and Disruptive Trading
17 Practices."

18 Bob Pease has been the team lead with Mark
19 Higgins, but they will be assisted by Vince McGunagle,
20 who is the acting head of the Division of Enforcement.
21 And you're not Ananda, but Brad Berry is Deputy
22 of our general counsel and appellate litigation there.

it

proposed

Director

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1 So Bob or whomever is taking the lead on this one.

2 MR. HIGGINS: Good morning, Mr. Chairman

amended

3 and Commissioners. In section 753 of Dodd-Frank

4 section 6(c) the Commodity Exchange Act. The team

rules

5 presentation today is proposing anti-manipulations

6 concerning two subsections.

of

7 New section (c)(1) expands the authority

8 the Commission to prevent any person from using or

9 attempting to use any manipulative or deceptive device.

10 Section (c)(1) is patterned after Section

11 10b of the Securities and Exchange Act of 1934, which

12 courts interpreted as a broad, anti-fraud, catch-all

13 designed to reach intentional or reckless conduct the

14 deems or defraud market participants.

15 New section (c)(1) is also similar to

16 anti-manipulation authority granted to the Federal

17 Regulatory Commission in 2005 and the Federal Trade

18 Commission in 2007.

19 FERC and the FTC have promulgating rules

modifications

20 based on SEC Rule 10b-5 with an appropriate

21 to their Regulatory Commission.

today

22 The first two proposed rules before you

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with 1 under Section 753 are also modeled on SEC Rule 10b-5
2 tailoring that reflects not only the distinct regularly
3 mission of the CFTC, but also CFTCs own experience and
4 precedent policing market manipulation and fraud.

5 In Section 753, Congress also created a new
6 section (6)(c) entitled "Other manipulation."

7 The second proposed rule before you today
8 mirrors the text of new Section (6)(c)(3). The purpose
9 of this rulemaking is to affirm certain legal practices
10 and principles relevant to the CEAs prohibition against
11 price manipulation of any swaps or any commodity in
12 intrastate commerce for future delivery.

13 Separately, Section 753 also provides for a
14 prohibition manipulation by false reporting that
affects 15 or tends to affect the price of any commodity.

16 This provision is entitled "Special
17 Provision by Manipulation by False Reporting," and no
18 rulemaking is needed to implement it.

19 Section 753 also protects against good
faith 20 mistakes that result in false or misleading or
inaccurate 21 information being transmitted to a price reporting
22 service.

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any 1 753 also prohibits any person from making
2 false or misleading statements of material fact to the
3 Commission.

4 As with the false reporting provision
5 previously mentioned, no rulemaking is needed to
6 implement this Section.

the 7 Finally, Section 753 expressly preserves
8 applicability of the anti-manipulation found in CEA
9 Section 9(a)(2).

10 Last, as stated in Section 754 of
11 Dodd-Frank, the prohibitions in 753 that require no
12 rulemaking will become effective in 360 days after the
13 date of enactment of Dodd-Frank.

14 The proposed rules before you, should they
15 become final rules, will become effective 60 days after
16 the final rules are publish for 360 days from the date
of 17 enactment whichever is later.

18 In the course leading up to this note
19 proposed rule, we received one public comment.

be 20 Before concluding my presentation, I would
21 remiss if I did not give acknowledge the individuals
22 contributions to the Assistant General Counsel, Ralph

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Attorney

as

will

one

I

1 Avery, Counselor Mary Connelly, and Enforcement
2 Brian Walsh to drafting these proposed rules, as well
3 the outstanding administrative support of Yolanda Smith
4 and the leadership of Bob Pease. That concludes my
5 presentation.

6 CHAIRMAN GENSLER: Thank you, Mark. I
7 entertain a motion on the staff recommendation on the
8 rule related to -- it's one rule, right? You mentioned
9 two.

10 MR. HIGGINS: Under 753 there are two
11 rules: One under subsection (c)(1)

12 CHAIRMAN GENSLER: Again, two motions?

13 MR. HIGGINS: They're contained within
14 document.

15 CHAIRMAN GENSLER: All right. Thank you.

16 will entertain a motion?

17 COMMISSIONER CHILTON: So moved.

18 COMMISSIONER O'MALIA: Second.

19 CHAIRMAN GENSLER: With discussion. I just
20 had one question. And sorry I didn't have anything
21 prepared for this one, but when you mentioned the SEC

22 Rule of 10b-5 and their statute provision 10b, you
remind

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SEC

1 me of insider trading. That that is how over at the
2 many cases have been brought.

3 Can you just walk us through how you would
4 address that theory and so forth?

So

5 MR. HIGGINS: Right. The CFTC, as you
6 know, does not have a prohibition on insider trading.

to

7 a market participate that is trading or hedging their
8 crops or their expected production would still be able
9 continue to do so. The rule does not upset any of the
10 Commissions long-standing precedence in that regard.

11 CHAIRMAN GENSLER: And is that because the SEC
12 put that in rule 10b-5 and you've not done that here?

More

13 MR. HIGGINS: That is true. 10b-5-1, I
14 believe is specific prohibition on insider trading.

15 fundamentally, the SEC's regulatory mission about the
16 disclosure. And part of that, it's not allowing market
17 participates to trade on inside information.

18 We're about product integrity of the market
19 recognizing that for people to hedge and for price to
20 discovery to occur, people will be trading on knowledge
21 that they have that's not public

22 CHAIRMAN GENSLER: I'm going to just say I

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it 1 support this proposed rulemaking today. I think that'
police 2 really helps the Commission broaden our ability to
3 markets as the statute says to make sure fair and
4 equitable trading.

practices 5 Congress granted the Commission this
6 authority in addition to the disruptive trading
7 authority. And I think this brings new under the first
8 half of it, which is called the "first rule" to police
9 for fraud-based manipulation. Whereas, this Commission
10 has had I guess what you call the other one price-based
11 manipulation in the past.

12 I would be remiss without thanking Senator
13 Cantwell for her leadership. She worked with Senator
14 Lynn I know in making sure that this part of their
15 statutory regime. Commissioner Dunn?

Chairman. 16 COMMISSIONER DUNN: Thank you, Mr.

17 I greatly appreciate saying this as a part of the
18 Dodd-Frank Act and the Commission acting on this. I
19 share the frustration of my fellow Commissioner Chilton
20 in his opening remarks.

21 It often times looks to us that things are
22 very apparent. When we get into the case law and

99

1 determining what is it manipulation, we find that our
2 hands are often tied. I think this goes a long way and
3 in helping our Enforcement Division.

4 I would want to make sure that
clarification

5 that everyone understands when we talk about any
6 manipulative or deceptive devise or contrivance, that
7 would also include any electronic, algorithmic-driven
8 trading. Is that correct?

9 MR. HIGGINS: If the elements of the rules
10 are satisfied, it matters not the vehicle by which the
11 person perpetrated the fraud.

12 COMMISSIONER DUNN: Thank you. I think
that

13 again issued a real challenge to both or Surveillance
14 Division and Enforcement Divisions to recruit folks
that
15 have a strong understanding of how these devices
operate.

16 Thank you, Mr. Chairman.

17 CHAIRMAN GENSLER: Thank you, Commissioner
18 Dunn. Commissioner Sommers?

19 COMMISSIONER SOMMERS: Thank you, Mr.
20 Chairman. I just have a couple of questions with
regard

21 to the new authority. The fact that we're all familiar
22 with the elements of proof of manipulation that we work

100

1 with under 9 (a)(2).

you

2 And if you could, first of all, answer if

new

3 know what kind of difference there would be under the

under

4 authority between a false reporting case or brought

5 9 (a)(2) and under this new authority.

all

6 MR. HIGGINS: Sure. Under 9(a)(2) as you

element

7 know is a four-part test. I won't recite all of those

8 elements except to say artificial price is a key

9 in that test.

brought

10 Artificial price is not a required element

11 under (c)(1). So a false reporting case could be

underneath

12 under (c)(1). And assuming it's not within the false

13 reporting that's already specifically defined

14 (c)(1) special provision for prohibition by false

15 reporting.

16 But let's just say it didn't fit in that

17 bucket and it was going to brought under (c)(1), the

18 elements, required elements would be that you prove up

19 the fraud, which would be the false report. That is as

20 done with intent. And now intent can be satisfied by

21 showing recklessness.

22

So unlike C(3) claim or the old 9(a)(2)

101

1 claim, there to requirement for specific intent under
2 (c)(1). Recklessness is enough.

3 And the last element would be that is has
to

4 be, the fraud has to in connection with a
jurisdictional

5 products. So a swap or a commodity in intrastate
6 commerce or a commodity for future delivery.

7 COMMISSIONER SOMMERS: Do you think that
8 there's any case that comes to mind for you that you
9 would be able to bring under this new authority that we
10 were not able to bring under 9 (a)(2)?

11 MR. HIGGINS: It's hard for me in the
12 abstract to think of the fact pattern that a person
that
13 the Commission could not have reached under one of its
14 prior authorities.

15 I will say though, harkening back to
16 Commissioner O'Malia's opening comment , that there
were

17 several prohibitions. This is an additive. This
18 supplements the Commission's existing anti-fraud and
19 anti-manipulation regimes.

20 And it's additive in the sense that for the
21 first time you have a manipulation rule that prohibits
22 fraudulent conduct. And so in that way it's different

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manipulation 1 and it's additive. Now you can get a market
 2 by fraud. And you can get there by proving that the
 3 intent element at least by recklessness.
we 4 So it's new and it's additive in the sense
 5 can now have manipulation by fraud.
 6 COMMISSIONER SOMMERS: Thank you, Mark.
just 7 MR. MCGUNAGLE: Commissioner, if I could
 8 expound a little bit on Mark's comment without going
back 9 to the cases that we filed or didn't make
recommendations 10 on, but look at the types of conduct at interest and
how. 11 I think Commissioner O'Malia hit it correctly about
this 12 continuum, how we evaluate our cases when we're looking
 13 at manipulative device, say illegal activity, wash
 14 trading, or pre-arranged trading. For example, how
that 15 is going to work in our evaluation in determining
 16 potential liability under 6 (c)(1).
 17 So conduct like, for example, where someone
 18 says that are testing the market on how the facts and
 19 circumstances evaluation during or investigation, what
 20 does that actually mean to test the market and what
steps

21 we're actually taken in furtherance.

22 So under 6(c)(1) we're looking at

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1 manipulative devices where we're looking at the conduct
2 that we see first as whether there's other violations
to 3 the Act like wash trading or pre-arranged or false
4 statements that has been enhanced through this
5 rulemaking.

6 False statements to the Commission.
7 Someone, for example, isn't up-front about the status
of 8 ownership of accounts. And that information might be
9 useful in terms of getting a true picture of what
at 10 actually the trading strategy is. As well as looking
11 what otherwise would have been legitimate devices as we
12 do in manipulation cases. But for intent become
13 illegitimate vehicle getting toward manipulative
14 activity.

15 So I think that the framework of the
16 evaluation is in place, but we now have additional
tools 17 to assist us in doing that evaluation.

18 COMMISSIONER SOMMERS: Thank you, Vince.

19 CHAIRMAN GENSLER: I think there's a little
20 bit of aversion. The document that we probably looked
at 21 last night said exactly what Vince said. It was
22 basically to use or employ or attempt to use or employ

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defraud. 1 any manipulative device, scheme, or artifice to

2 I want to confirm that's what we're talking
3 about. Not that we're worried about what will go out
of

4 this building, but right now we have another document
5 that might have gotten pulled of a share point site
6 internally that didn't have the final orders in it.

7 MR. MCGUNAGLE: You are correct.

8 CHAIRMAN GENSLER: I just want to confirm
9 that because I have same share point site here.
10 Commissioner Chilton?

11 COMMISSIONER CHILTON: Mr. Higgins said
12 exactly what I wanted to make a point on, but I will
put

13 a little bit finer point on it. And it went
Commissioner
14 Sommers' question.

15 This doesn't make the standard that existed
16 that exists currently, the manipulation standard that I
17 spoke about that's referred to, it doesn't change that.
18 It is additive. So it's a new thing that we could go
19 after folks for along with the disruptive trade
practice.

20 So we've got more tools, but there's still
21 that high standard that we've only had one successful
22 manipulation case in 35 years, correct.

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1 MR. HIGGINS: That is correct. In the
2 absence of fraud, you have a pure (c)(3) case. That
3 standard doesn't change.

4 COMMISSIONER CHILTON: A lot of folks have
5 asked me why don't they get on with it and put this
stuff
6 in place. One, we've been getting it on for a long
time.
7 The Chairman set this whole process up on the rules
even
8 before the bill passed. You all and everybody else
9 that's been in this building and Chicago and New York
are
10 working very hard on these rules. So we are moving
11 forward on them.

12 I also want to point out and I guess I'll
13 make it a question. We're prohibited by law
implementing
14 this until next July. Is that correct?

15 MR. HIGGINS: That is correct. The statute
16 in Section 754 I, which I mentioned in my presentation,
17 prohibits the Commission from giving affect to any rule
18 or provision before 360 days from enactment.

19 COMMISSIONER CHILTON: Okay. Even it's all
20 done today, we couldn't implement it and couldn't start
21 working?

22 MR. HIGGINS: Yes.

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1 COMMISSIONER CHILTON: Mr. Chairman, are we
2 waiting to go around on the disruptive practices, or do
I 3 do that now? What would you prefer. I had a question
4 about destructive practice.

5 CHAIRMAN GENSLER: It's meant to be
separate.

6 COMMISSIONER CHILTON: Okay.

7 CHAIRMAN GENSLER: Commissioner O'Malia?

8 COMMISSIONER O'MALIA: Mr. Chairman, I have
a 9 lengthy list of questions.

10 CHAIRMAN GENSLER: That's why we're here.

11 COMMISSIONER O'MALIA: And I would be happy
12 to ask them if somebody wants to interrupt and take
some 13 turns going around, I'd be happy to break them up.

14 CHAIRMAN GENSLER: Do you want us to ask
some 15 of your questions for you?

16 COMMISSIONER O'MALIA: We might divide it.
I 17 have several pages and I can give everybody one. I
just 18 want to be respectful to other Commissioners. And if
you 19 have a question and you want to jump in, please don't
20 hesitate to cut me off. I will keep asking question

21 until I run out of paper.

22 I do appreciate the team's efforts here.

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I 1 We've worked very hard to make this a better product.
2 especially want to thank Laura Gardy, my senior counsel
3 whose done an outstanding job to approve this product,
as 4 well. I appreciate you all working with her.

5 As I note in my statement, I think that we
6 would all benefit, that Mark would benefit, we as
7 Commissioners, and Enforcement Division would benefit
by 8 understanding what processes are going to be allowed or
9 not allowed. That's a lots of flavoring in my
questions.

10 CHAIRMAN GENSLER: I was just going to say that
11 disruptive trading practices are separate. We can do
12 them all together, but I have to give Commissioner
13 Chilton a chance, too, on disruptive trading practices

14 COMMISSIONER O'MALIA: I'm happy to break
15 them up.

16 CHAIRMAN GENSLER: Thank you.

17 COMMISSIONER O'MALIA: I just wanted to get
a 18 better understanding. 6(c)(1) the violation, is it
19 \$140,000 per violation or a million dollars? I'm
trying 20 to understand this conduct is manipulation (6)(c) (1)
21 what would be the penalty be ?

22

MR. HIGGINS: 6 (c)(1) is styled "The

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rule 1 prohibition on manipulation." So if you violate the
\$1 2 promulgated under that, the penalty set forth is up to
3 million dollars in Section 753.

a 4 COMMISSIONER O'MALIA: In order to satisfy
5 violation of 6 (c)(1) you must prove that there was,
6 quote, "manipulative or deceptive device or
contrivance."

7 How would we prove that? What make something
8 manipulative or deceptive?

9 MR. HIGGINS: Those words, manipulative
10 device or contrivance, were first interpreted by the
11 Supreme Court. In that case, the Supreme Court said
12 those words were terms of art that the meaning could be
13 found only in the statute.

14 In so doing -- and this is under 10b law --
15 they interpreted those words to mean fraud. So to
16 violate (c)(1) and the rule proposed rule promulgated
17 thereunder, should it become final rule, you would have
18 to show fraud existed.

19 Now, in the preamble -- I'm sure your next
20 question will be what is fraud -- in this context
fraud 21 is a term of art. Fraud it's not associated with all
the

22 common law element of fraud that you would have in
state

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1 law action.

2 Here, fraud in the preamble we propose to
3 mean any conduct that impairs, obstructs, or defeats a
4 well-functioning market or the integrity of the market.

5 COMMISSIONER O'MALIA: Would a individual
6 trade strategy be manipulative because each bid and
offer

7 will feed a price trend? How will we look at that?
8 Would we look at it by bid and offer, or we look at a
9 kind of scheme?

10 MR. HIGGINS: Here's where it's difficult
11 from where I stand because these cases are really fact
12 and circumstance specific. So to -- and I'm going
leave

13 you wanting, I think, with your question because
without
14 those facts and circumstances, it's hard to give
meaning

15 to these words. They don't mean much in isolation.
They
16 mean something when they're enveloped by any given
case.

17 So I really, I defer to others, but I don't have
18 a good answer for you without factual record around
which
19 to apply the rule.

20 CHAIRMAN GENSLER: Are there cases?
Because

21 really what happened with Senator Cantwell worked to
22 insure that FERC had these authorities FTC had these

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SEC

1 authorities, and now we have these authorities as the
2 has over decades. So maybe if there is guidance from
3 other cases. Brad or Vince?

4 MR. MCGUNAGLE: I do I think, as Mark said,
5 this will be a case-by-case development.

the

6 When I was speaking earlier to Commissioner
7 Sommers, I focused on, for example, activity that we've
8 already found to be illegal because I think that making
9 the arguments in front of the courts with respect to
10 activity that already violates some aspect of the
11 Commodity Exchange Act. That working an evaluation
12 statute saying in furtherance of it's a manipulative
13 device or deception, that that will be, should be
14 persuasive to the court.

market.

15 As we talk about other areas of trading
16 activity, where arguably, you know, it might otherwise
17 appear to be legitimate trading, you know, on the

manipulative

18 But we're offering that there is a
19 manipulative scheme in play. And so the actual trade
20 strategy that's being employed constitutes a
21 or deceptive device under 6 (c)(1). And the courts

will

as 22 help guide us in terms of how those issues get decided

111

1 we go forward.

of

2 So I don't think there's going to be a
3 hard-and-fast rule coming out of the applicability of 6
4 (c)(1) after the effective date. There will be a lot
5 discussions in the cases just going forward.

the

6 CHAIRMAN GENSLER: I'm sorry. I'm just
7 trying to hep. But wouldn't the Courts -- and maybe
8 Brad, because you're an appellate litigator, wouldn't
9 courts look to a lot of the law that's been established
10 by the courts around the Securities And Exchange
11 Commission enforcing the same words?

that

12 MR. BERRY: Yes, they would. And the
13 proposed ruled acknowledges that talk about the fact
14 there's been a lot of case law developed under Section
15 10b and 10b-5.

16 And that, in many respects, the we're
17 proposing that this provision be guided by the law that
18 has developed around 10b and 10b-5) with appropriate
19 modifications.

20 CHAIRMAN GENSLER: Commissioner O'Malia?

be,

21 COMMISSIONER O'MALIA: Thank you, Mr.
22 Chairman. The manipulative or deceptive devise must

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1 quote, "Used in connection with a jurisdictional
2 transaction," correct?

3 MR. BERRY: That's correct.

4 COMMISSIONER O'MALIA: Can you help me
5 understand how the SEC is interpreted this and how
we're

6 interpreting this in our rulemaking? And maybe any
7 flavor you can -- is there a nexus between the conduct
8 and the jurisdictional transaction?

9 MR. HIGGINS: Right. So the Supreme Court
10 again has weighed in on this specific issue in
connection
11 with the SEC versus Sanford case, which can came down
in
12 200w.

13 In that case, the Supreme Court breathed
14 light in the three-words phase "in connection with" by
15 saying: So long as the fraud coincides with the SEC
16 jurisdictional transaction, there is that sufficient
17 nexus, as you said.

18 Now, the Court was careful in that case to
19 not be unlimited. I believe it's footnote 4 of that
cas

20 the Court went on to say -- this was a 9-0 case, by the
21 way. I think it was unanimous. The Court said: When
22 we're saying "in connection with," it's not limitless.

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who 1 So they gave the example of a stockbroker
2 steals cash. Not a money-market fund, but cash from a
3 client's account and uses that cash to buy real estate.
4 There is a not a sufficient nexus. And you would not
5 violate 10b-5 under that fact pattern.

6 So it's broad, is as the entire rule. It's
7 meant to be flexible, but it's not limitless.

with 8 COMMISSIONER O'MALIA: I think I'm done
9 my disruptive trading practices questions.

10 CHAIRMAN GENSLER: Manipulative questions.

11 COMMISSIONER O'MALIA: Right. Yes.

12 CHAIRMAN O'MALIA: I gather, and I think
13 Commissioner O'Malia's questions are very helpful,
we're 14 not alone in this because there's a tremendous amount
of 15 case law, I think. There's a tremendous amount of case
16 law, and that's what I understood, at least I
understand

17 was the intent of Congress here. So if we have new
18 fraud-based manipulation, it wouldn't be, as you say,
19 unfounded because it would be grounded in this case
law.

20 And you've answered a very important second
21 question, Mark, is that we're not trying to incorporate

22 the insider trader piece in that case law, but if you

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1 could you answer those two pieces to the questions

of

2 MR. HIGGINS: Yes. Justice Renquist said

3 10b-5: That from a egg corn a new oak has grown.

4 CHAIRMAN GENSLER: Which Justice was that?

law

5 MR. HIGGINS: Renquist. So he's making a

6 point in this statement there is a huge body of case

sure

7 under 10b-5 that we can avail ourselves to. And I'm

8 the courts will too as they interpret it. So yes, we

9 will be guided by but tailored to our specific mission.

reiterate

10 As far as insider trading, just to

it

11 this rule does not prohibit insider trading, nor does

12 impose any new duty of disclosure on any market

13 participants.

says

14 There's a specific provision in 753 that

15 you do not have to divulge inside or confidential

if

16 information to the public before you trade. However,

not

17 you do speak, you must speak fully and completely and

18 be misleading in your statements.

19 CHAIRMAN GENSLER: Other questions?

20 COMMISSIONER O'MALIA: Thank you, Mr.

21 Chairman. Your question did bring up in what I think
22 will be helpful is helping everybody understand how
this

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1 continuum works as I noted. 9(a)(2) in our statute,
2 obviously, and we're not getting rid of that. Do you
3 want to elaborate on what that relationship is?

4 MR. HIGGINS: Yes. I think it's status
quo,
5 as far as 9(a)(2). So I think today, just as we have
in
6 the past, a person, depending on the right facts and
7 circumstances could conceivably be charged with
multiple
8 (c)(1) violation and a 9(a) (2) violation.

9 Congress was explicit that 753 would not
10 upset 9(a)(2) or the applicability of 9(a)(2).

11 COMMISSIONER O'MALIA: Now, you've showered
12 praise on the SEC 4 and FERC for their new authorities.
13 We are not without our own fraud authorities. How will
14 those be -- and in case law therein. So how are we
going
15 to use our case law? Are we going to band in it, or
are
16 we going to just go with SEC, or stand by it?

17 MR. HIGGINS: No. We do not and we're
clear
18 in the preamble and I tried to make clear in our
19 precedence, this is new authority. It's new. But we
20 have decades of precedent in policing fraud
manipulation.
21 We have no intention amending that.

22

I think any manipulation case that was

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1 brought before could still potentially be used in
2 guidance in cases going forward on.

3 COMMISSIONER O'MALIA: So now we have the
4 SEC, FERC, our fraud, 9(a)(2), obviously this is
5 extraordinarily complicated. We've given you
significant
6 tools. Congress has given us significant tools
obviously
7 with fraud and manipulation in changing the price
element
8 a little bit here.

9 Now how do we form the industry of how
10 they're going to be charged what the rules are going to
11 be going forward and what applies? Are they going to
be
12 a 6(c)(1)? 6(c)(3)? 9(a)(2)? Fraud versus
13 manipulation?

14 You did dodge the 140 versus million-
dollar
15 question earlier on whether it will be fraud or
16 manipulation because it has that reckless standard in
17 there. What's the market to think about all of this?
18 How can we give them the confidence, or what bin they
19 will be bucketed? There's no confidence.

20 MR. HIGGINS: Again, I'm not trying to
dodge
21 your questions. I'm simply saying that this area of
the

22 law is extremely fact and circumstance dependent. So
to

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is 1 tell you today how somebody would be charged tomorrow
respect 2 foolish from where I sit. So, you know, in that
and 3 or with that caveat, everything is still on the table
 4 it always will be.

charge 5 If a specific fact person merits a 4b
 6 but not (c)(1) charge, that would be something that the
 7 Commission would consider.

profile 8 And a fact patten that may fit that
fraud, 9 is where you have somebody that is perpetrating a
sufficient 10 they have requisite intent, but there in not a
 11 connection through a connection jurisdictional
 12 transaction. If they're selling widgets or something
 13 like that that aren't jurisdictional, maybe you have a
4b 14 fraud and not a (c) (1) fraud.

there's 15 So as you can see with every new fact
 16 a new permientation and new analysis that goes into
this. 17

MR. BERRY: Can I add just one comment?

CHAIRMAN GENSLER: Please.

MR. BERRY: The one thing that I would hope

of 20 that would be of comfort to the industry is that most
O'Malia, 21 the provisions that you just recited, Commission
 22 requires specific intent or intent to defraud.

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1 So in most instances, with the exception
2 recklessness under (c)(1) if you are acting without
3 fraudulent intent or without specific intent to
4 manipulate to effect the price, you should be okay.

It's

5 when you are acting with that intent that you can get
6 into trouble.

7 MR. HIGGINS: And just one other point with
8 recklessness. I want to be real clear on this. It's

not

9 your standard tort definition, recklessness. The

courts

10 are very clear in securities context and we are in our
11 rulemaking and in our preamble in the cases we cite.

12 When we say "recklessness," we mean a lesser showing of
13 intent. We don't mean a higher degree of negligence.

I

14 hope that's eliminating. I just want to make that

point.

15 People aren't, I don't think, are going to
16 stumble into a (c)(1) violation. You have to have the
17 requisite of that intent.

18 COMMISSIONER O'MALIA: Thank you, both.

19 CHAIRMAN GENSLER: I can tell we have four
20 extremely, accomplished, and knowledgeable lawyers. I
21 didn't go to law school, but I followed most of that.

22 COMMISSIONER CHILTON: Mr. Chairman?

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Chilton. 1 CHAIRMAN GENSLER: Yes, Commissioner

2 COMMISSIONER CHILTON: I would just want to
3 compliment, and I appreciate Commissioner's O'Malia's
4 questions. I think they're good questions.

5 As I think all of us here know,
particularly

6 the Chairman, this language was sort of a compromise
that

7 was sort of banged out at the 11th hour of the
8 conference. And, well, people may write if differently
9 from one person or another. Congress wrote it, and
it's

10 the law. And so this is what we're left with. And I
11 think you all have done a really spectacular job in
12 putting a lot of meat on the bone.

13 I do look forward to the comment we will
get

14 on this because I. Do think there's some legitimate
15 questions. But I compliment you on the work that
you've

16 done so far.

17 CHAIRMAN GENSLER: Again, if there are no
18 further questions, I will entertain a call of the
19 question. All that's in favor say "Aye"?

20 (Chorus of ayes.)

21 CHAIRMAN GENSLER: Any nays? It being

22 unanimous 5-0, we'll send this one, as well, to the

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1 Federal Register. Some of you can stay, or all of you
2 can stay for disruptive trading practices.

great

3 Brad, don't go anywhere. We have four

are

4 lawyers here. I don't want to give you up. So Bob,

5 you going to present this one?

morning,

6 MR. PEASE: Yes, Mr. Chairman. Good

like

7 Mr. Chairman. Good morning, Commissioners. I would

8 to introduce our team member with the anti-manipulation

9 and disruptive trading practices, the matter we're

10 discussing today.

lot

11 As you can see from Mark's presentation a

12 of hard work and very high qualify work was put into

Godell

13 these efforts. Ralph Avery, Mary Connolly, Maria

14 from the Office of the General Counsel. William Pennet

15 from DCIO. Christine Sorenson and Michael Pennet from

16 OCE. James Goodwin and Dave Taft from DMO. And Mark

17 Higgins, of course, Brian Walsh and Jeremy C. From

18 Enforcement.

Brad

19 I would also like to thank John Mark B.,

20 Berry, and Andre C. For their invaluable assistance in

21 these matters.

22

Today we're here to discuss an advanced

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1 notice of proposed rulemaking concerning Section 747 of
2 Dodd-Frank which prohibits, among other things,
specific
3 trading practices disruptive that are disruptive of
fair
4 and equitable trading.

5 Separately and not part of our proposed
6 rulemaking, Section 747 also makes it unlawful for any
7 for any person to enter into swap knowing they're
acting
8 in reckless disregard the fact that its counterparty
will
9 use the swap as part of their device to scheme or
10 artifice to defraud any third party.

11 Section 747 under Dodd-Frank, in Section
747
12 under Dodd-Frank, Congress expressly prohibits certain
13 trading practices that it determines is disruptive to
14 fair and equitable trading.

15 Congress made it unlawful to violate bids
or
16 offer demonstrate intentional or reckless disregard for
17 the orderly execution of transactions during the
closing
18 period, or is of the character of, or is commonly know
19 the trade as "spoofing." And spoofing is defined as
20 bidding or offering with the intent to cancel the bid
or

21 offer before execution.

Commission 22 Dodd-Frank Section 747 grants the

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are
1 optional rulemaking authority to promulgate such rules
2 and regulations as in the judgment of the Commission
3 reasonably necessary to prohibit trading practice
4 enumerated and any other trading practice this is
5 disruptive to fair and equitable trading.

Frank
6 The prohibition on the three disruptive
7 trading practices specified in Section 4c(a) become
8 effective 360 days after the enactment of the Dodd-
9 Act.

10 In this proposed advanced notice proposed
11 rulemaking, the staff requests comments to 18 questions
12 ranging from the Commission to promulgate additional
13 guidance on the three enumerated statutory provisions.

monitoring
14 Promulgation prohibition against additional
15 disruptive trading practice, supervision, and
16 requirements, and applications of rules to electronic
17 trading and algorithmic automated trading systems.

contained
18 For example, some of the questions
19 in ANOPR are: Should the Commission provide additional
20 guidance as to the nature of the conduct that is
21 prohibited by the specifically enumerated paragraphs
22 practices in the statutes.

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1 How should the Commission distinguished
2 spoofing as articulated the statute from a legitimate
3 trading act where an individual enters an order larger
4 than necessary with the intent to cancel part of the
5 order to ensure his or her order is filled.

of

6 Does a partial fill of an order or series
7 orders necessarily exempt that activity from being
8 defined as spoofing.

9 Should there be obligations to supervise
10 against prohibited trading practices.

11 Similarly, should executorial brokers have
12 affirmative obligation under the rules to ensure that
13 customer trades are not disruptive.

14 Should the Commission consider promulgating
15 rules to regulate the use of algorithmic trading to
16 prevent disruptive trading practices. And, if so, what
17 kind of rules should the Commission consider.

automatic

18 Should the Commission consider promulgating
19 rules to regulate the design of algorithmic or
20 trading systems to prevent disruptive trading

practices.

21 Should the Commission consider promulgating
22 rules to regulate the supervision and monitoring of

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1 algorithmic or automatic trading systems to prevent
2 disruptive trading practices.

3 And should the Commission promulgate
4 additional rules specifically applicable to the use of
5 algorithmic trading programs, front trading
6 methodologies, and programs reasonably necessary to
7 prevent such systems from disrupting fair and equitable
8 markets.

9 The staff is recommending a 60-day comment
10 period for this advanced notice. The staff also
intends
11 to hold a public roundtable discussion on December 2,
12 2010, to provide a forum to discuss questions contained
13 in the ANOPR, as well as other issues prospective
14 commentators may raise. Thank you. I'll will be happy
15 to answer any questions.

16 CHAIRMAN GENSLE: I think I'm supposed to
17 first entertain a motion. So I'll entertain a motion.

18 COMMISSIONER SOMMERS: So moved.

19 COMMISSIONER CHILTON: Second.

20 CHAIRMAN GENSLE: With that just questions
21 on this I don't have really have. I just want to say
I'm
22 supporting the proposed advanced notice of proposed

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1 rulemaking.

they

2 I think that Congress in granting us these
3 additional authorities on disruptive trade practices

C.

4 listed three. And you pointed to the questions A. B.

5 But I think it is helpful to ask the public how to best
6 give meaning to those three points, give specificity to
7 those three points.

8 Not everybody in the marketplace knows what
9 it is to, quote, "violate a bid or offer," but it's in
10 the statute now. And not everybody knows what spoofing
11 is. So I'm glad that we would ask questions.

12 I was more helpful in the last three months
13 we would get more public comments. How many comments
14 have we gotten into our e-mail boxes on this?

not

15 MR. PEASE: On disruptive trading, we did

16 receive any.

that

17 CHAIRMAN GENSLER: So I'm really hopeful

18 market participants understand that it is at least this
19 Chairman's intent to move forward on rulemaking.

bids

20 I think it is incumbent to do rulemaking to
21 give greater meaning to first three points violating

22 and offers and spoofing and so forth. But also to

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1 consider whether we had a D or E or F as the provisions
2 provide.

will

3 In the 18 questions, we asked a series of
4 questions also with regard to automated trading. We

busy

5 have a staff roundtable I think it will be December 2.
6 We had a lot other staff roundtables, so this will
7 probably take a similar format. But when there are
8 schedules for November, this is just frankly the first
9 time we got those. I think I think that will be very
10 helpful.

meeting

be

the

11 In moving forward, these possible comments
12 will also be informed by the Joint Advisory Committee,
13 the CFTC. The Joint Advisory Committee, the CFTC has a
14 Joint Advisory Committee. November 5 is our next
15 with that. But during this period of time, I wouldn't
16 surprised we have some comments and advise back from
17 committee and additional meetings.

period

18 So I think all of this public comment
19 on these 18 questions, the Joint Advisory Committee, I
20 hope that market participates. They're also busy.
21 They're busy making markets and hedging their risks and

22 so forth. They're business trying to racket to our
rules

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out 1 and the SECs rules, but I hope they would help us on
 2 on this one. But I don't have any specific questions.
 3 Commissioner Dunn?

Chairman. 4 COMMISSIONER DUNN: Thank you, Mr.

forward 5 I have no specific questions on this. I do look
 6 to that roundtable on it. I appreciate the hard work
in 7 there. And I would implore the public to take part.

 8 I also would like to thank all of the staff
been 9 and the participants in the roundtables that we have
 10 having. I think last Friday was a very, very good
work 11 roundtable event. And I really appreciate the hard
 12 that goes into that and what's coming out of it.

13 CHAIRMAN GENSLER: Commissioner Sommers?

14 COMMISSIONER SOMMERS: Thank you, Mr.
entirely 15 Chairman. I would just like to say that I agree
 16 with what you were just saying about these rules and
 17 being able to get public comment because this
rulemaking 18 -- although this rulemaking is optional, I do think
that 19 the practices that are expressly prohibited under
Section

20 747 the A. B. C are less than clear. And I would
suggest
21 that any sort of rulemaking that we would do our --
our
22 goal through any sort of rulemaking here would be to
make

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1 them as clear as possible.

that

2 I know this is enormously complex. And

3 working through these sort of complicated issues is not

4 easy. And I want to say how much I appreciate this

to

5 team's effort in this area. But that the public needs

6 understand that this roundtable on December 2 is really

7 important for us.

8 I think, let's see, if we put the rule out

9 today, they will have about three weeks after that

extent

10 roundtable to get their comments in under a 60-day

11 period.

they

12 So just to suggest to the public that if

13 have certain sections with regard to the ability for us

in

14 to make these rules very clear, that they participate

15 this process.

about

16 CHAIRMAN GENSLER: Thank you. Actually,

17 we'll probably get an extra week. It always takes

18 a week between us and the Federal Register.

19 That, by the way, for the press is not us.

20 We usually hit the send button shortly or within 24

21 hours. But the Federal Register has a process to get

seven 22 into the Federal Register that's been taking six or

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1 days. Commissioner Chilton?

2 COMMISSIONER CHILTON: Thank you, Mr.

3 Chairman. That last point that Commissioner Sommers
was

4 making about making things as clear as possible, I
think

5 is important.

6 But what we've learned is that we also want
7 to preserve some discretion in the future because you
8 either look at what people are thinking now about
robotic

9 trading like algorithmic trading had the Flash-Trade
10 Report come out nine months ago instead of after the
bill

11 was passed, maybe there would have been a provision in
12 the law that would sort of outlaw algorithm anomalies.

13 So I think we just need to be cognizant that
14 this authority can change in future if we see something
15 else.

16 Folks are always looking for ways around
the

17 laws and regulation. And this, while I agree with
18 Commissioner Sommers, to be clear, it also allows us to
19 possibility change things in the future.

20 There was an old Styx song Mr. Roboto. Do
21 you remember what it said there: The problem is plain
to

22 see. Too much technology.

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1 Now, I don't think there's too much
2 technology, but we've definitely seen instances this
year
3 where algorithms go wild and it costs people money.
And
4 it's not acceptable for the trader to just say sorry.
My
5 bad. To me it seems like that should be punished in
some
6 way.

7 The Chairman and Commission Sommers talked
8 about not getting a lot of comments on this. I gave a
9 talk yesterday in Las Vegas to 200 engineer traders.
And
10 they were not asking many questions, so I asked them
some
11 questions. By the way, the first question is: Is 70
12 percent of a market too much? People raised both
hands.

13 The other question where I go unanimity
14 was: Should algorithmic traders and algorithmic
programs
15 that wild and impact royal markets, should they be held
16 accountable? Everybody raised their hand.

17 Now, that's not an official, public
comment,
18 but it seems to me even though you asked those four
19 questions in here 15 through 18 about algorithmic
20 traders, do we really want to add one more.

21 I don't know if my colleagues would agree,

22 but something should algorithmic traders who impact
royal

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fashion 1 markets be held accountable. And, if so, in what
2 or something like that. And if the staff would like to
3 fine-tune my question, or if the Chairman would like to
4 second.

second 5 CHAIRMAN GENSLER: I would be glad to
6 if you change royal to disrupt. I think that's what
this 7 is a disruptive trading practice.

8 COMMISSIONER CHILTON: Yes.

9 CHAIRMAN GENSLER: That's an amendment that
10 we'll go to at the proper time.

11 COMMISSIONER O'MALIA: Yes, I would like to
12 associate myself with Commissioner Chilton's remarks on
13 this. This is a good question to ask.

14 COMMISSIONER CHILTON: I will move my
15 question.

16 CHAIRMAN GENSLER: All in favor of the
17 amendment to add the question?

18 (Chorus of ayes.)

19 CHAIRMAN GENSLER: Any opposed? I think
it's 20 unanimous. We have Commissioner O'Malia's rest of the
21 list of two pages.

22 COMMISSIONER O'MALIA: Right. I'd like

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1 associate myself with Commissioner Sommers' comments on
2 this issue. These are complicated. The specifics
3 matters and we're asking some questions. But, again, I
4 will try to inquire with the staff how to some of these
5 are being treated going forward.

6 Obviously, under 4c(a) of our current
7 authority, the first three A through C might be
covered.

8 How do you respond to that? Is this redundant with
9 4c(a), or not?

10 MR. Yes: Are you asking whether -- can you
11 repeat the question? I'm sorry, I didn't follow it.

12 COMMISSIONER O'MALIA: Disruptive trading
13 practices, are they're covered under 4c(a) already?

14 MR. PEASE: Yes.

15 COMMISSIONER O'MALIA: The disruptive
trading
16 practices described in Section 747 is described in the
17 e-mail for generally prescribed pre-trade conduct.
18 Absent in the ad hoc how analysis, how will the
19 Commission monitor for these violations?

20 MR. PEASE: Monitor in advance?

21 COMMISSIONER O'MALIA: Monitor at all.
Pre.

22 Post.

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1 MR. PEASE: We've been working with the DMO
2 and we will continue to work with them to come up with
3 different markers that they would be able to use to try
4 to figure out whether that would be violations. But I
5 think it's a little bit premature to say what they
would
6 use for the surveillance activities. That's the
purpose
7 of this ANOPR to get more comments. As the
Commissioner
8 would say: Put more clarity around these terms.

9 And as we get more clarity, then I think we
10 can build some surveillance programs to be able to look
11 at those type of practices in advance.

12 COMMISSIONER O'MALIA: Great. What are the
13 civil monetary penalties attached with each of these
14 violations?

15 MR. PEASE: If they would be brought
16 understanding Section 747 alone, they would be \$140,000
17 plus restitution, as well.

18 COMMISSIONER O'MALIA: If the \$1 million
19 dollar a day applies only to manipulation, could these
be
20 viewed as a scheme and therefore be subject to \$1
million
21 dollar a day?

22 MR. PEASE: There could be circumstances.

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that

1 Depending upon the facts and circumstances, conduct
2 may also violate is 747 would be a manipulation.

3 COMMISSIONER O'MALIA: With regard to the
4 bids, the violation of bids or offer, what are the
5 elements of a violation of this provision? What is the
6 level of intent, specifically, are we looking for?

seeking

7 MR. PEASE: That's exactly what we're
8 comments on. Right now the statute doesn't state what
9 the intent would be for violating bids and offers. I
10 think we would be looking at both specific intent and
11 recklessness behavior.

12 COMMISSIONER O'MALIA: Are there any
13 instances that you can think of where a trader may bid
14 for over but not be in violation of this provision?

15 MR. PEASE: I would rather not speculate on
16 various fact patterns there. Again, it's very fact and
17 circumstance specific.

18 COMMISSIONER O'MALIA: How about a
19 hypothetical? What if a price at NYMEX and Globex they
20 pick a price that might have been lower on one rather
21 than the other. Would be that be considered bidding to
22 the offer? With all these steps coming into play, how

we

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1 would deal with that?

2 MR. PEASE: We would have to look at the
3 totality of the circumstances at look at the intent.

4 MR. BERRY: Can I interject?

5 COMMISSIONER O'MALIA: Sure.

6 MR. BERRY: Before you get too far done
your

7 list, I want to call to your attention.

8 I'm looking at 4c(a) in my green book, and
9 it's not clear to me how that intersects with the
10 disruptive practices in 747.

11 I think one of the question that you've ask
12 whether disruptive practices that Congress spelled out
in

13 747 are already cover in Section 4c(a). And I don't
see

14 that they are in the terms that Congress used.

15 It may be that for the provision that
you're

16 referring is a broad provision that could encompass
some

17 of those, but I don't see -- for example, 4c(a), I
don't

18 see anything about violating bids or offers or
spoofing.

19 So I wanted to -- I'm not sure that when Bob answered
20 that question, he's seems to say -- I think he meant
21 4c(a), right?

22

MR. PEASE: As I understand your question,

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1 Commissioner, the statutory requirement in A. B. and C,
2 no rulemaking is needed to give effect to those. And
3 then we are promulgating the rule that reflects those,
4 that mirrors those already enumerated provision and
5 giving more meaning to them, if that was your question.

6 COMMISSIONER O'MALIA: Right. That was my
7 question. Thanks. With regard to the reckless intent
8 that the orderly execution, the disregard for orderly
9 execution of the close, do we have any thoughts on how
10 you might define ordinarily execution?

11 MR. PEASE: That particular area we're
12 seeking comment on. We're also seeking comment on what
13 action defines closing period, good activity in advance
14 which has been executed during period, what all would
15 encompassed to cover those terms. They're not defined
16 all and there's little, if any, legislative history.

17 I'm a little concerned about the vagueness
18 this probation that might prevent people from trading
19 the close.

20 We have these trade and settlement &
21 contracts on the Exchanges. How will those be treated?

22 MR. PEASE: That will be an opportunity in

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1 the next roundtable to be able to make -- clarify those
2 issues and address them specifically. We won't be
3 looking at here; although it doesn't use those type
4 words. Market and close. That's type of activity that
5 we're trying to prohibit here, not legitimate behavior
6 during the closing period.

7 MR. MCGUNAGLE: Certainly with respect to
8 using TAZ, the TAZ trading activity is subject
impending
9 Commission compliance against an entity by the name of
Exchange
10 Optibor. But in promulgated the rules with the
11 and in conversations with the Exchange about conduct
12 that's otherwise disruptive on the market and what that
13 the Exchange is doing to ensure that there is
sufficient
14 liquidity during the closing range to accomplish the
goal
15 of the close to get an appropriate or meaningful
16 settlement price and how is that activity that there
17 isn't attraction by -- distraction during the closing
18 range when we're effecting what the closing price
should
19 be.

20 COMMISSIONER O'MALIA: And question 12,
it's
21 a disorderly execution question. How are we defining

22 that? Are you asking for definition? Do you have a

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1 sense what the definition might be? Do you have an
2 opinion on that?

the

3 MR. MCGUNAGLE: No. Again, this would be
4 another -- this is a fact and circumstances. I think
5 analysis that we will have getting some input certainly
6 from industry about where they would we maybe there's
7 markers currently activity that disorderly, but the
8 expectation is that we're going to be developing this

in

9 cases as we evaluate the trade strategies and make the
10 recommendations and have discussion with these traders
11 about whether we see conduct as being violative.

but

12 CHAIRMAN GENSLER: Let me just jump in,
13 Commissioner O'Malia. I think this is an amendment,
14 question 12 can you add -- and it's an amendment to see
15 support it -- if so because you have an if so, what

size?

16 Well, you do have it. You do have it. How should it
17 distinguish between orderly and disorderly?

question,

18 COMMISSIONER O'MALIA: To the size
19 my question is how are we going define particularly
20 orders?

large

21 MR. PEASE: That's one of the things we're

22 seeking comment on. What we're trying to do is get

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1 objective criteria that we can use for what would
2 consider a large trade. So it would vary over the
3 circumstances.

4 And there are regulations that say what 15
5 (0)(3) in our regulations right now which have some
6 guidance, but that may not be appropriate in this
7 circumstance. So we're looking to see to get comments
8 what would constitute a large trade. And then once we
9 have a large trade, when it's as the questions are

asking

10 for concerning disorderly execution of those, does that
11 vary over time. Does it vary under circumstances of
12 market conditions.

13 We're looking for comments along those
14 directions because it can be -- a large trade can go in
15 at a certain time of the market and not cause a
16 disruption, other times depending on facts and
17 circumstances. Should there be a monitoring question.
18 We're asking another question where you're monitor this
19 large trade as it's come into the market. And taking
20 into account and consideration such as what's changed
21 during the day and what's changed when they made the
22 decision to execute that transaction. All different

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1 factors we want to look at.

2 We're asking the question should there be
3 additional controls when you're having a large trade
4 which would have the potential to disrupt the market.

very

5 COMMISSIONER O'MALIA: Well, you have a

technology

6 difficult job in defining this with regard to

7 and the Advisory Committee. And we've asked many of

or

8 these questions. We either get different definitions,

9 different ideas about what's the definition means for
10 various strategies. Good luck.

11 MR. PEASE: We look forward to working with
12 your committee to try help solve this problem.

no

13 CHAIRMAN GENSLER: Thank you, Commissioner
14 O'Malia for your thoughtfulness on this. If there are

15 further questions on disruptive trading practices
16 advanced notices for proposed rulemaking, I will then
17 call the question. All in favor say "Aye"?

18 (Chorus of ayes.)

here.

19 CHAIRMAN GENSLER: Any opposed? The ayes
20 being unanimous, we will send this on to the Federal
21 Register. Let me find the right thing to read from

22 If I'm allowed to do this, this is

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on

at

1 housekeeping in trying to set up a new meeting schedule
2 and so forth. But first I need a unanimously consent
3 something.

4 The Sunshine Act Commission rule requires
5 one-week notice of the subject matter to be considered
6 a public meeting. And I actually asked a lawyer
7 yesterday could we consider today what our next meeting
8 is. Apparently, we didn't notice the public that we'd
9 just be talking when our next meeting is.

10 So I would like a vote to approve that,
11 though we didn't notice that we would vote on when our
12 next meeting was, that we just vote to pick our next
13 meeting.

the

14 So consequently, I guess in order to ensure
15 that we conduct this meeting, and in accordance with
16 Sunshine Act, the Chair will entertainer a motion that
17 the business of the Commission requires a change in
18 todays agenda so we actually discuss when our next
19 meeting is.

20 COMMISSIONER SOMMERS: So moved.

21 COMMISSIONER O'MALIA: Second.

22 CHAIRMAN GENSLER: All in favor say "Aye"?

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1 (Chorus of ayes.)

2 CHAIRMAN GENSLER: Any opposed? We did
that

3 administrative thing. Now, in terms of our next
meeting

4 -- we always want to be in accordance with the Sunshine
5 Act. In terms of the next meeting, I think that

Deborah
6 Ridgeway, who does all this scheduling between us, I
said

7 three dates in November. One of them might end up
being

8 December 1.

9 December 10 -- we'll put this all in
Federal

10 the Register. December 10 -- November 10. November 10
11 from 1:00 to 4:00 in the afternoon. November 19, which
12 must be all day thing, but it's 9:30 to 5:30. I think
we

13 have a calendar here internally six or seven of these
14 things.

15 And then December 1, actually, even though
we
16 were trying to do November 30. I think somebody wasn't
17 available December 1 again in the morning 9:30 to
12:30.

18 So I would like offer a motion that those
are

19 our next three meetings. And, of course, as we have
been

20 seven days before putting it on our website the actual
21 agenda items of the meeting. Do I hear a second?

22 COMMISSIONER SOMMERS: Second.

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"Aye"? 1 CHAIRMAN GENSLER: All in favor say

2 (Chorus of ayes.)

3 CHAIRMAN GENSLER: Any opposed? No

three 4 opposed. That is carried unanimously that are next

5 meetings are the 10th, 19th, and December 1st.

6 I do think we still, just for the press,

7 we're sort of anticipating two meetings after the

8 December 1st one. We're human. Some of this is going

to 9 slip, inevitably.

10 I know we're getting down to the crunch

time, 11 so there will be somebody inevitably, because we're

12 coordinating a lot with the SEC, the Federal Reserve,

and 13 other others, as well.

14 Do I need to also do a unanimous consent

for 15 any technical corrections? So I have one last thing to

16 do on the script.

17 At this point, I also ask unanimous consent

18 to allow staff to make technical corrections to

documents 19 voted on prior today prior to sending them to the

Federal 20 Register. And I will make that motion.

21 COMMISSIONER SOMMERS: Second.

22 CHAIRMAN GENSLER: All in favor, "Aye"?

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1 (Chorus of ayes.)

2 CHAIRMAN GENSLER: Again, I want to thank
3 everybody. I don't know if my fellow Commissioners

have

4 closing remarks. But we've done 30 topics areas that
5 we're plowing through. Whether we're through a quarter
6 or a third, we know that this an lawful lot to get

done,

7 but we're trying to get these out so the public can
8 comment.

9 We'll change the final rules that will be
10 given in the proposals all in accordance with the
11 Administrative Procedures Act. But I look forward to
12 seeing you all back here on November 10.

13 Any other closing? No. With that, I
14 guess I need a motion to adjourn the meeting.

15 COMMISSIONER SOMMERS: So moved.

16 COMMISSIONER O'MALIA: Second.

17 CHAIRMAN GENSLER: All in favor say
"Aye"?

18 (Chorus of ayes.)

19 CHAIRMAN GENSLER: The meeting is
20 adjourned. Thank you.

21 (Whereupon, the PROCEEDINGS were adjourned.)

22 * * * *

